

The Cannabis Industry In New York State

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“This is a historic day in New York, one that rights the wrongs of the past by putting an end to harsh prison sentences, embraces an industry that will grow the Empire State’s economy, and prioritizes marginalized communities so those that have suffered the most will be the first to reap the benefits,” stated Governor Andrew Cuomo on Wednesday, March 30, 2021.

This historic day is referring to the effort to legalize cannabis in New York State, which was years in the making. On Wednesday, March 31, 2021 Governor Cuomo finally achieved this goal and signed legislation a mere 12 hours after the legislature approved it. New York is now the 16th state to allow recreational marijuana use for adults, making it fully legal in the state.

The final legislation covered the following:

- Individuals in New York will be allowed to possess up to 3 ounces of marijuana;
- New Yorkers can grow up to three mature pot plants at home, with a limit of six per household;
- New York will expunge the criminal records of people previously convicted of crimes that would be legal under the new law;
- It is expected to create up to 60,000 jobs;
- It is estimated that it will generate approximately \$350 million in annual tax revenue for the state;
- It will impose a total sales tax rate of approximately 13% allocated as follows: approximately 9% to the state, approximately 3% to the municipality where the sale is made, and approximately 1% to the respective county. From the 9% allocated to the state, approximately 40% has been dedicated to communities disproportionately affected by prior drug laws. Approximately 40% has been allocated to schools in those communities, with approximately 20% allocated to drug treatment and education.



Issues to Consider When Operating a Cannabis Business in New York

With the passing of this law, it will only be a matter of time before we see business starting to take root in New York State. Yet we must remember that even though it is legal in New York, it is still illegal on the federal level and in other states which could pose certain issues.

- **Taxation** – Because cannabis is a Schedule I drug, a cannabis business is subject to Internal Revenue Service (IRS) Code Section 280E which disallows the deduction of ordinary business expenses in arriving at taxable income. Code Section 280E results in significantly higher effective tax rates for cannabis businesses than for other businesses.
- **Interstate trafficking** – Cannabis has been on the U.S. Schedule I controlled substances list since 1970. Regardless of state laws, cannabis is a Schedule I drug according to the federal government, and those found trafficking in cannabis could face criminal prosecution under the Uniform Controlled Substances Act. Cannabis is now fully legalized in 16 states. Cannabis is legalized for medicinal purposes only in 32 states, four of the five permanently inhabited U.S. Territories, and the District of Columbia. In two states and one of the five permanently inhabited U.S. Territories, cannabis is still illegal.
- In addition, since it is not federally legal, each state has its own regulations as to what constitutes being within the law. This creates additional issues when trying to sell your product to other states, as well as, and possibly more importantly, procuring the plant.
- **Banking** – Since the plant is still scheduled as a drug by the federal government, many banks are not allowed to accept money or create loans because it would be recognized as money laundering. This creates an obstacle for cannabis companies to overcome as they are prohibited from banking with a federally insured bank. This forces the business to bank with private banks and lose the protection offered by federally-insured banks.
- **Licenses** – There are regulatory limits on licenses of cultivators, product production, and dispensaries. In some states there are strict requirements and a hefty price to obtain licenses; in other states there are limits on the number of licenses that can be issued. This could create a competitive advantage for those that have already secured and maintain their license. Conversely, since it is still federally illegal, a company looking to branch into other jurisdictions could be faced with burdensome regulatory approval —often with a residency requirement of ownership to do business in other states, or even other municipalities within the same state.

Increase Potential Value as One Starts a Cannabis Company

The number one challenge that the cannabis industry faces is that it is illegal under federal law to grow or sell the product. With cannabis still being illegal on the federal level and in many states, how does one increase the potential valuation of their cannabis business? Here are a few key points that will help you maximize the value of your cannabis company:

- Buyers of cannabis businesses typically want to see a record of profitability, indicating that the business has good potential to expand future earnings. It is important for the seller to be able to show its business has been set up with the necessary infrastructure to allow for future growth, and show that it will not be bogged down with unnecessary costs. This includes proof the business is complying with applicable state and local laws.
- Buyers of cannabis businesses want to know that the selling company has locked down its trademarks. A strong and protected brand can add immense value to a company.

- Buyers are generally not interested in taking on existing debt as part of their purchase.
- Buyers want a cannabis business with a good (preferably long-term) lease and short-term sales contracts.
- Seller financing of the final price plays a key role, and marijuana business sellers willing to accept payment other than an upfront lump-sum check are likely getting higher prices.



What's Next

The cannabis industry is rapidly changing and with change comes opportunity. If you are the owner of a cannabis business, now is the time to start thinking about and preparing for the future. With New York now on line as fully legalized, should you consider expanding your operations into one of the greatest cities and state? As a business owner, what you do today and the ground work you lay will set up the future, and could very well be the deciding factor whether or not you are successful.

Because the industry is continually evolving, it's essential for owners of cannabis businesses to partner with the right professionals early on in the process. We at Empire have the background and expertise and can become your trusted advisor to assist you and your business in these changing times. Who you partner with can either help make your buds bloom or stunt the potential for your business's growth.

Since our founding in 1988, Empire Valuation Consultants has grown into one of the nation's leading and most respected independent valuation firms, with a staff of over 80 employees in New York City, Long Island, Boston, Rochester, West Hartford, and San Francisco. We bring excellence and integrity to every engagement through our team of highly skilled individuals who are among the finest our industry has to offer. Our valuations are prepared by senior accredited valuation experts holding one or more of the following professional credentials: CFA, ASA, IA, CPA, and ABV. We provide valuations to attorneys, accountants, business owners, private equity and hedge funds, commercial bankers, investment bankers, trust departments, insurance agents, and financial planners, among others.



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