The Public Benefits of Banking Cannabis Businesses

American Bankers Association®

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I. Introduction

As of early 2019, 33 states and the District of Columbia have legalized cannabis use in some form. These jurisdictions cover roughly 70% of the U.S. population. However, the possession, distribution, or sale of cannabis remains illegal under federal law. Because of the conflict between state and federal law, most banks will not provide services to the industry. This means that most cannabis firms and their suppliers are typically forced to operate in cash — posing heightened economic and security risks to customers, employees, and the larger community.

The problems caused by blocking cannabis and cannabis-related businesses from the banking sector are only going to grow as the cannabis industry expands. According to industry analysts, the legal cannabis industry now exceeds $10 billion and employs as many as 160,000 workers.[1] Conservative estimates suggest that the legal cannabis market will grow to $25 billion by 2025,[2] while more expansive projections have the industry reaching $75 billion by 2030.[3] As a result, the industry is expected to create at least 300,000 jobs by 2020.[4]

While the debate over legalizing marijuana continues, there are clear public benefits in allowing banks to serve cannabis businesses in the states where voters have chosen to make it legal in some form. This paper outlines some of those benefits, including:

- **Increased support for local economic growth.** Allowing the industry to access banking services will ensure that its employees, suppliers, and service providers also remain within the banking system, supporting sustainable local economic growth.
- **Improved security and safety.** Cannabis businesses are increasingly targeted by criminals due to the vast amounts of cash they handle. Banking the industry will improve public safety by reducing the amount of cash kept on hand.
- **Reduced tax evasion.** Tax evasion is pervasive among cash-reliant businesses. Banking cannabis businesses will improve financial transparency and nudge the industry toward improved tax compliance.
- **Increased efficiency of tax collection.** Because they are unbanked, many cannabis businesses make tax payments in cash, posing challenges to federal, state, and local governments. Banking the industry will allow cannabis businesses to make secure, efficient electronic payments instead.
- **More accurate assessments of economic risks.** Banking cannabis businesses will make it possible to evaluate the industry's performance and develop a clearer picture of its impact in the local economies to which it contributes.

Each of these topics are explored in greater depth below.

II. Support Growth of Local Economies

As the cannabis industry grows, it will become increasingly integrated into local economies. This has great potential to boost local growth and expand the tax base, but that growth may be tempered if the industry's employees, suppliers, and service providers are excluded from the banking system.

This rapid expansion has spurred indirect growth across local economies as cannabis businesses require services and supplies from lawyers, consultants, data analysts, climate engineers, insurers, real estate companies, security specialists, marketing firms, and HVAC businesses among others. For example, the Marijuana Policy Group estimates that nearly 30% of the 18,000 jobs added to Colorado's economy in 2015 due to cannabis legalization were generated by demand for supplies and services from cannabis businesses and general spending by cannabis industry employees.[5]

The Federal Reserve Bank of Kansas City reports that as a result of these trends, about 5.5% of the total change in Colorado employment in the first half of 2017 is attributable to the cannabis industry,[6] demonstrating that the cannabis sector is integral to the local labor market and underscoring the importance of accurate data pertaining to the industry's performance.

However, if the industry, along with its suppliers and service providers, cannot access the banking system, new employees risk being cast aside into the shadow economy. This includes workers at businesses that provide marketing, real estate, security, insurance, legal, and consulting services, as well as manufacturers and climate engineering, construction, and HVAC specialists.[7] In Colorado alone, excluding both cannabis and "cannabis-periphery" businesses from the banking system would increase the state's unbanked population by 20%.[8]

Anecdotal evidence suggests that segments of local economies are already losing access to banks because of their business relationships with cannabis firms. For example, security companies that provide much-needed services to cannabis companies cannot access traditional loans to buy armored trucks and expand their operations despite heightened demand for their services.[9] Lawyers, data analysts, and accountants who serve cannabis businesses have similarly found themselves frequently dropped by their banks, as have agricultural supply companies that furnish cannabis dispensaries with soil and tools. The same is true for climate engineering firms that work with cannabis growers and companies producing accessories used for legal cannabis consumption.[10]

Furthermore, since cannabis businesses cannot access the banking system, it is more difficult to reinvest the industry's revenues — which by some estimates could reach $75 billion by 2030 — into the community via bank lending.[11] Instead, cash proceeds gather dust in business-held safes.

III. Improve Security and Safety

Cannabis businesses are attractive targets for criminals – and they endanger owners, employees, customers and communities because they operate predominantly in cash. Banking the industry will mitigate this risk and keep communities safe by reducing the vast amounts of cash that cannabis businesses currently handle, store, and transport.

Colorado has one of the most developed cannabis markets, and thus the impacts of the cannabis industry there make a compelling case study. According to the City of Denver, cannabis businesses make up less than 1% of all local businesses but have accounted for 10% of all reported business burglaries from 2012-2016.[12] Within a year of legalization, Denver's community of approximately 325 cannabis businesses experienced over 120 burglaries and robberies. This burglary problem remains acute. On average, more than 100 burglaries occur at cannabis businesses each year according to the Denver Police Department.[13] Burglaries and theft comprise almost 80% of Denver's cannabis industry-related crime.[14]

Anecdotal evidence from other locations where cannabis is legal is consistent with the experience in Denver. Government officials in California's "Emerald Triangle" (the Mendocino, Humboldt, and Trinity Country area -- home to the nation's largest cannabis-growing region) have described a surge in home invasions and missing person cases as criminals seek out cannabis business' stockpiles of cash. Similarly, there has been an increase in media reports of burglaries, murders and kidnappings of cannabis dispensary owners and security guards across California, Washington, and Oregon.[15]

Major Neil Franklin, Executive Director of the Law Enforcement Action Partnership, noted in 2019 testimony before the U.S. House Committee on Financial Services that "current conditions, which require all-cash transactions in every aspect of the [cannabis] business encourage tax fraud, add expensive monitoring and bookkeeping expenses, and — most importantly — leave legitimate businesses vulnerable to theft, robbery, and the violence that accompanies those crimes."[16]

In May 2019, a bipartisan group of 38 state attorneys general sent a letter to ten congressional leaders recognizing that cannabis business' preclusion from the banking system and reliance on cash "contributes to a public safety threat as cash intensive businesses are often targets for criminal activity."[17]

Similarly, in April 2019, a bipartisan group of 17 state treasurers sent their own letter to congressional leaders, noting that "Processing, storing, and moving large amounts of cash puts business owners, their employees, and their customers at risk of violent crime."[18]

Former deputy director of the National Cannabis Industry Association (NCIA) Betty Aldworth stated in 2014 that "The lack of access to banking is hands down the single most dangerous aspect of legal marijuana."[19]

While not specific to cannabis, a 2014 study published by the National Bureau of Economic Research found that by switching from paper-based payments to electronic payments, states can reduce overall crime levels by nearly 10%. The study found a notable decrease in the prevalence of burglary, larceny, and assault — crimes often committed in pursuit of cash.[20]

IV. Combat Tax Evasion

Tax evasion is common among cash-based businesses, constituting the norm rather than the exception.[21] Given their lack of access to banking services, the risk of tax evasion among cannabis businesses is higher than traditional businesses. Moreover, this risk could extend beyond cannabis businesses to their employees, suppliers, and service providers. Banking the cannabis industry would improve financial transparency and reduce both the opportunity and incentive to evade taxes.

Due to the hard-to-trace nature of cash transactions, it is common for cash-based businesses to intentionally underreport income. Myriad studies published by behavioral economists demonstrate that due to the low-visibility of cash-based transactions, taxpayers are less likely to report cash income than payments received by check or those subject to third-party reporting or withholding.[22]

Cash-based businesses face competitive pressures to evade taxes. New York University (NYU) researchers concluded that due to extensive noncompliance across the cash business sector, "honest" business owners who would otherwise comply with tax laws often cave under the pressure and evade taxes in order to remain competitive with their tax-evading competitors.[23] The IRS estimates that income underreporting across the cash economy is the single largest contributor to the U.S. tax gap, leading to revenue losses of about $100 billion annually.[24]

Although compliance rates are difficult to estimate, researchers at Stanford University suggest that cash-based businesses underreport their income by at least 50%.[25] Self-employed individuals operating businesses on a cash basis (a description that fits most cannabis proprietors) report less than 20% of their income to the IRS.[26]

Although the cannabis industry is regulated and therefore likely more tax-compliant than unregulated cash-based businesses, initial studies show that there are still significant tax evasion challenges in the current environment. The city of Sacramento estimated that cannabis dispensaries amass $9 million per year in underpaid taxes due to poor recordkeeping or filing inaccurate financial statements with local tax collectors. This tax evasion amounts to nearly double the revenue collected by the city through fees and taxes on annual reported cannabis sales.[27]

Given that tax revenues from the cannabis industry are often earmarked for education and public health initiatives, compliance is critical to the well-being of local communities. For example, Colorado allots $40 million annually from the state's cannabis tax to the construction and renovation of schools, $18 million to public health and cannabis education, and $8.4 million to boosting literacy, improving graduation rates, and reducing bullying.[28]

Banking the cannabis industry is a straightforward way to ensure that businesses have the means and motivation to remain fully tax compliant.

V. Increase Tax Collection Efficiency

Cannabis businesses frequently pay taxes and fees in cash because they are unbanked, which presents additional collection challenges to government agencies. Allowing banks to serve the cannabis industry would eliminate these inefficiencies and allow cannabis businesses to quickly and securely file tax payments electronically, as other legal businesses do.

The U.S. government collected an estimated $4.7 billion in taxes from cannabis businesses in 2017, and industry analysts estimate that up to $17.5 billion in federal, state, and local tax revenues could be generated by 2030.[29] Since only 30% of cannabis businesses hold a bank account, most firms pay their taxes in cash at local IRS offices. They make their payments in secure rooms equipped with machines that count and verify the authenticity of each bill.[30]

Processing such paper-based returns costs the IRS nearly 17 times more compared to an e-filed return,[31] and sometimes requires local tax offices to invest in additional security measures. IRS offices in Oregon and Colorado have invested millions in safety glass and security cameras.[32] Further, the IRS has agreed to pay nearly $2 million to the Mitre Corporation to assist with processing tax payments received in cash from the cannabis industry.[33]

The IRS typically assesses a 10% penalty on companies that pay taxes in cash rather than electronically. However, since cannabis businesses are precluded from the banking system, the IRS does not levy these charges on the cannabis industry. The IRS, and therefore taxpayers, bear the full brunt of these additional cash-counting costs.[34]

State and local governments experience similar struggles with processing all-cash tax payments. A 2018 survey conducted by the Council of State Governments found that the majority of state governments intend to move away from paper-based tax payments in order to reduce the cost of collection.[35] However, the lack of access to banking among cannabis businesses suggests that tax offices in Colorado, California, and Washington likely collected much of the nearly $1 billion in cumulative tax revenue generated by this industry in cash.[36]

VI. Accurately Access Economic Risks

The cannabis industry's heavy reliance on cash poses a challenge to policymakers seeking to accurately assess its size and economic health. This in turn, makes it difficult to assess the opportunities and risks that may develop in local economies that are heavily reliant on the industry. Banking the cannabis industry and bringing it out of the shadows will enable policymakers, economists, and researchers to monitor and evaluate the industry's performance and, by extension, achieve a better understanding of the health of local economies to which it contributes.

The cannabis industry shapes local economies not only through its impact on the labor market, as detailed above, but also through its impact on local property values. Colorado's legal cannabis industry has driven investment in cultivation and retailing infrastructure and boosted competition for warehouses, driving property values higher.[37] According to CBRE Research, the influx of dispensaries has led average warehouse lease rates in Denver to double.[38] As the industry expands, it may continue to influence real estate prices and thus introduce into the local economy new risks and opportunities that could be difficult to measure due to the industry's lack of access to the banking sector and heavy reliance on cash.

Furthermore, since the cannabis industry is administered at the state-level, most cannabis spending remains within the borders of the state where it is spent. As a result, the industry generates more local output and employment per dollar spent than most other sectors, and its performance is likely to be felt by the local economy more than that of similarly sized sectors whose transactions cross state lines.

For example, the Marijuana Policy Group has found that each dollar spent on cannabis retail in Colorado generates $2.40 in state output. By comparison, the traditional retail sector generates only $1.88 per dollar, and the mining sector generates just $1.79 per dollar spent.[39] As a result, fluctuations within the local cannabis industry could have a greater impact on local economies than that of other sectors.

End Notes

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[3] Cowen Equity Research (2018).
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[5] Marijuana Policy Group (2016), "The Economic Impact of Marijuana Legalization in Colorado.".
[6] Kansas City Federal Reserve (2018), "The Economic Effects of the Marijuana Industry in Colorado."
[7] Kleperis (2017), "Investigating the Role of Financial Institutions in the Legal Cannabis Industry" and Marijuana Policy Group (2016), "The Economic Impact of Marijuana Legalization in Colorado."
[8] Marijuana Policy Group (2016); U.S. Census Bureau (2018), "Quick Facts Colorado"; Kansas City Federal Reserve (2018), "State Profile: Colorado."
[9] Guillot (2018), "Marijuana, Banks, and the Perils of a Growing Business."
[10] Testimony Submitted on Behalf of the National Cannabis Industry Association before the U.S. House of Representatives Consumer Protection and Financial Institutions Subcommittee (2019); Chiang (2017), Letter to the California Congressional Delegation; Miller (2017), "Cannabis-Industry Lawyer Raises Questions After his Bank Terminates Account"; Horowitz (2018) "Cannabis in Canada: Big banks are missing a boom."
[11] Cowen Equity Research (2018).
[12] City of Denver (2018), "The Denver Collaborative Approach: Leading the way in municipal marijuana management."
[13] Burglary data available from the Denver Police Department. See: City of Denver Open Data Catalog (2018). According to an analysis of licensing data conducted by cannabis-industry data analytics firm Marijuana Business Daily, there were approximately 325 cannabis companies in Denver as of 2014. See: CNBC (2014), "Robber Gangs Terrorize Colorado Pot Shops."
[14] According to the City of Denver, in 2017 burglary or attempted burglary accounted for 67% of cannabis-industry related crime and larceny accounted for another 12%. See City of Denver (2018), "The Denver Collaborative Approach: Leading the way in municipal marijuana management."
[15] Chiang (2017), "Banking Access Strategies for Cannabis-Related Businesses"; Northwest High Intensity Drug Trafficking Area (2017), "Washington State Marijuana Impact Report: Volume 2"; NBC (2018), "Marijuana dispensary robbery caught on camera."
[16] Franklin (2019), Testimony of Major Neill Franklin.

[17] State Attorneys General Letter to Congress (2019).
[18] State Treasurers Letter to Congress (2019).
[19] Altman (2014), Pot's Money Problem.
[20] Wright et al. (2014), "Less Cash, Less Crime: Evidence from the Electronic Benefit Transfer Program."
[21] Morse et al. (2009), "Cash Businesses and Tax Evasion"; Lederman (2003), "The Interplay between Norms and Enforcement in Tax Compliance"; Slemrod (2001), "Cheating Ourselves: The Economies of Tax Evasion"; Bankman (2007), "Eight Truths About Collecting Taxes from the Cash Economy." Roth et al. (1989), "Taxpayer Compliance: An agenda for research"; Andreoni et al. (1998), "Tax Compliance"; Richardson and Sawyer (2001), "A Taxonomy of Tax Compliance Literature: Further Findings."
[22] Robben, Hessing, and Elffers (1990), "Legal Controls and Type of Employment in Tax Evasion Behavior;" Robben et al. (1990), "Decision Frame and Opportunity as Determinants of Tax Cheating"; Webley et al., (1991), "Tax Evasion: An Experimental Approach"; Richardson and Sawyer (2001); Lederman (2003); and Morse et al. (2009).
[23] Bankman and Karlinsky (2001), "Cash Business Owners and Their Tax Preparers," quoted in Lederman (2003); Morse et al. (2009).
[24] The "cash economy" refers to taxable income from legal activities not reported to the IRS by third parties. This definition includes businesses operating strictly in cash, as well as others that handle a portion of their transactions in cash or receive other payments not subject to third party reporting. See IRS (2007), "A Comprehensive Strategy for Addressing the Cash Economy."
[25] The "cash sector" includes small businesses with low-to-medium incomes that sell primarily at the retail level and often receive and make payments in cash. See Morse et al. (2009); Bankman (2007).
[26] U.S. Department of the Treasury (2006), "A Closer Look at the Size and Sources of the Tax Gap."
[27] Conti-Brown (2018), "The Policy Barriers to Marijuana Banking."
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[30] Marijuana Business Daily (2015), "Sixty Percent of Cannabis Companies Don't Have Bank Accounts."Rohrlich (2018), "Cannabis companies are paying federal taxes in cash and it's giving the IRS a headache;"Baily (2018), "How do I pay my tax without a bank account?"; Smith (2018), "IRS collects billions in pot taxes, much in cash."
[31] GAO (2010), "2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains are Possible in Others."
[32] Quinton (2016), "Why Marijuana Businesses Still Can't Get Bank Accounts"; Arrowsmith (2017), "IRS Goes Green"; Mordock (2018), "Cash is King."
[33] USASpending.gov (2018), Contract Summary.
[34] Rohrlich (2018) and Brager (2015), "Penalty relief available for cash-only businesses."
[35] 32 states responded to the Council of State Governments' survey. Of these, 72% reported that the cost of collecting and processing payments was their main reason for accepting few paper-based payments. Council of State Governments (2018), "Cash-less State Governments: Electronic Collections and Benefit Disbursements."
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