You Down with CBD? Yea You Know Me – States Look to Incentivize and Tax Growing Hemp Industry

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Planting the Seed – How the Hemp Industry Began to Bloom

Few products have ever taken the market by storm quite like hemp-based products have over the past year, with the most popular being CBD, or cannabidiol, a natural compound extracted from hemp with various recognized uses including potential health benefits.

The sudden rise of these products has led to several state and local tax issues and opportunities in a very short-time frame which must be closely monitored as this growing industry continues to bloom.

Hemp, which differs from its higher-THC cousin, marijuana, has been legal in many states for years but not fully legal at the federal level until late 2018 when Congress passed the Farm Bill[i] which has allowed the hemp market to skyrocket. Recent reports estimate that the hemp industry, which accounted for approximately $1.1 billion in revenue in 2018, will more than double to approximately $2 billion to 2.6 billion by 2022[ii], while another report makes a bold prediction that the CBD market alone may reach $22 billion by 2022 [iii]. Regardless, these are startling numbers from an industry that essentially didn't exist some five years ago.

The hemp market has gotten so big so fast that domestic farmers are having a tough time keeping up, but several states are doing everything they can, such as Colorado which projects to have approximately 50,000 acres of hemp by the end of 2019, Kentucky which predicts it will have five-times more hemp farmers (1,047) and three-times more approved acreage (over 50,000 acres) than in 2018 and currently has over six-million square feet of greenhouse hemp cultivation, and Oregon and Tennessee in which the number of licensed hemp farmers grew 25% and 12% in 2018, respectively. [iv] Several other states like North Carolina, Indiana, Ohio, Texas, Vermont, North Dakota, and Minnesota are quickly trying to be

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considered more "hemp friendly" states.[v]

It's not just oils anymore as CBD "infused" products are in high demand after cross-pollinating CBD, so to speak, with various other consumer products, including lotions, foods, beverages, vaping products, and almost anything you can think of. Likewise, a variety of "industrial hemp" products are being manufactured throughout the country from hemp fibers (e.g., fabric, apparel, insulation, flooring, paper, plastics, rope, car parts, building materials, etc.), hemp oil (e.g., cooking ingredients, supplements, cosmetics, fuel, detergents, paint, etc.) and hemp seeds (various food and beverages). As is typical when a new industry pops up, especially one that is highly regulated like hemp, states are quickly trying to determine how best to legalize, regulate, tax and incentivize this growing business, with a handful of states at the forefront of this movement.

Cultivation – States Look to Incentivize Hemp Production

Certain states have made concerted efforts over the past few years to not only legalize and incentivize hemp production, but also streamline the licensing of same, given the likely increased tax revenue and tens of thousands of potential new jobs across multiple sectors as a result of this blossoming industry. This gives businesses in the hemp industry a lot of leverage to negotiate with multiple states to obtain the best possible state and local tax and financial incentives available to land its production operations, with states like Kentucky leading the way in this regard.

For example, my Old Kentucky Home has awarded several substantial incentives over the past year, including $1.8 million in tax incentives in 2018 for a large facility in Mayfield, Kentucky that will store, dry and extract CBD from Kentucky-grown hemp in return for its projected $40 million investment and creation of approximately eighty (80) new jobs.[vi] Prior to that, Kentucky approved $2.4 million in corporate tax credits and wage assessments, as well as job training incentives, for a new 50,000-square-foot facility in Paris, Kentucky that expects to employ nearly 300 people and will initially produce a CBD-infused energy drink and then expand to other hemp products.[vii] And most recently in July, an expansion

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of a hemp facility in Lyon County, Kentucky as well as a new CBD oil extraction and distillation facility in Boyle County, Kentucky were announced, including substantial corporate tax incentives for both projects.[viii]

There has also been a recent trend for farmers to transition from more traditional farm products to hemp due to the decreasing profit margins in these former products, such as a Kentucky-based greenhouse that announced in 2019 that it will convert its longstanding ornamental bedding plant production solely to cultivating high-CBD products.[ix] A similar example can be found in Indiana, where a grain company recently decided to convert its food factory to CBD production, becoming one of the first to be licensed in the Hoosier state, and worked closely with the local economic development agency to receive various accommodations for same.[x]

Another incentive-leading state is Colorado which recently created a specific fund for hemp farmers to hire interns to continue growing the knowledge-base for hemp production, as well as approved incentives for hemp operations through its Advanced Industries Accelerator program designed to bolster startups that use innovative technologies by providing tax credits, funding and job training programs and large grants, including a recent $250,000 grant for a company's planned processing of hemp waste into bioplastics and other products.[xi]

It appears the sky is the limit for potential state and local incentives not only in these leading states, but throughout the country, as most states already have generic manufacturing and technology based incentive programs that hemp producers could qualify for; however, until these other states provide more clarity on hemp laws, regulations and licensing, many of these operations (and the tax revenue, capital investment and employees that go along with it) will continue to prefer "safer" options like Kentucky, Colorado, Oregon and others that have been ahead of the curve.

Harvest Time – Hemp Could Be a Cash Crop for Many States Needing Revenue

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Once a state has enticed a hemp manufacturer or producer to come to its state through incentives and/or business-friendly licensing and regulations, then the question becomes, how will it tax these products? Should they simply be subject to sales tax like other consumer products? Should they be subject to a special excise tax in addition to or in lieu of sales tax, like tobacco and other products in certain states? It appears state and local jurisdictions are still trying to make up their minds as they decide how best to reap the benefits of these operations, as guidance has been scarce thus far.

Vermont is one of the rare states that released clear rules and guidelines for the taxation of hemp and hemp-related products[xii], including clarifying that the purchase of hemp plants are exempt from sales and use tax under its agriculture exemption. Vermont takes the position, however, that CBD is generally subject to sales and use tax as it does not qualify for various potentially applicable exemptions for agriculture supplies (as it is not used and consumed directly in the production of sale of tangible personal property on farms), food and food ingredients (as it is consumed for its therapeutic, not taste or nutritional, value), or dietary supplements, with the one exception being for a FDA-approved CBD that qualifies as an exempt drug. Additionally, any CBD incorporated into a taxable meal is subject to the state's higher (9%) meals and rooms tax in lieu of sales tax (only 6%). Moreover, Vermont, like many states, also has a local option sales tax which would add an additional 1% to the tax due (totaling 7% for sales tax or 10% for meals tax).

It is reasonable to predict that most states will follow the basic sales tax rules used by Vermont – i.e., that hemp itself is an exempt agriculture product and that hemp and CBD-based products are subject to sales tax unless an exemption applies. But every state has different statutory exemptions, some of which are much broader than those in Vermont, and based on the speed in which new types of CBD-related products are popping up on the market, some new products may eventually qualify for a previously closed exemption.

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States will also continue to enact or enforce unique taxes like Vermont's meals tax, or a specialized excise tax on hemp like Louisiana recently enacted.[xiii] Some states may instead create specific exemptions for hemp-related products or production materials/equipment to help incentivize this industry just as Montana recently did in creating a property tax exemption for hemp processing machinery.[xiv] And while major retailers are now heavily involved in CBD sales, because the primary distribution channel for this market has historically been through online sales, many CBD companies are sure to have a steep learning curve with multistate taxation compliance and nexus concerns after Wayfair. [xv]

One must keep a close eye on these state (and local) level tax developments in the coming months as states begin to understand the rapidly growing hemp industry better, and then determine how best to regulate, license, tax and incentivize same. But one thing is for sure, hemp is going to continue growing, and the yield will be bountiful, no matter rain or shine.

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[i] The Agriculture Improvement Act of 2018, H.R. 2, 115th Cong. (2018), available at https://www.congress.gov/bill/115th-congress/house-bill/2/text.

[ii] Bob Woods, CNBC, "newly legalized hemp industry set to create a jobs boom in the US" (May 25, 2019), available at https://www.cnbc.com/2019/05/24/newly-legalized-hemp-industry-set-to-create-a-jobs-boom-in-the-us.html (last visited Jul. 15, 2019); Hemp Business Journal, U.S. Hemp Industry Grows to $820mm in sales in 2017, available at https://www.hempbizjournal.com/size-of-us-hemp-industry-2017/ (last visited Jul 10, 2019).

[iii] BrightfieldGroup, "Hemp-Derived CBD Market to Reach $22 Billion by 2022 (Sept. 13, 2018), available at https://www.brightfieldgroup.com/post/hemp-cbd-market-to-reach-22-billion-by-2022 (Last visited Jul. 10, 2019).

[iv] Laura Drotleff, "Hemp boom: States report dramatic licensing increases for 2019," Hemp Industry Daily (Mar. 25, 2019), available online at https://hempindustrydaily.com/hemp-boom-states-

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dramatic-licensing-increases-2019/ (last visited Jul 12, 2019).

[v] Id.; Hemp Industry Daily, "Hemp Report: Top 10 U.S. States" (2018), available at https://mjbizdaily.com/wp-content/uploads/2018/04/Hemp-Report_Top-10-US-States.pdf.

[vi] Jeff Smith, "Landing tax incentives, grants for your hemp business," Hemp Industry Daily (Apr. 10, 2019)

[vii] "AgTech breaks ground on $5M industrial hemp operation, creating 271 jobs," The Lane Report (Oct. 18, 2018); https://www.lanereport.com/106890/2018/10/agtech-breaks-ground-on-5m-industrial-hemp-operation-creating-271-jobs/.

[viii] "Lyon County hemp operation plans $2.7M expansion; 16 jobs," The Lane Report (Jul. 26, 2019), available at https://www.lanereport.com/115424/2019/07/lyon-county-hemp-operation-plans-2-7m-expansion-16-jobs/; Tom Latek, "Hemp plant moving into Boyle County area," Kentucky Today (Jul. 16, 2019), available at http://kentuckytoday.com/stories/hemp-plant-moving-into-boyle-county-area,20560 .

[ix] Laura Drotleff, "Top ornamental greenhouse operation ColorPoint making transition to hemp," Hemp Industry Daily (May, 30, 2019), available at https://hempindustrydaily.com/top-ornamental-greenhouse-operation-colorpoint-making-transition-to-hemp/.

[x] "PHM Brands, LLC Chooses Michigan City for Industrial Hemp Processing Plant," Michigan City, IN Economic Development Corporation (Apr. 2019), available at https://www.edcmc.com/phm-brands-llc-chooses-michigan-city-for-industrial-hemp-processing-plant/

[xi] *See* Jeff Smith, "Landing tax incentives, grants for your hemp business," *supra* n. 6; Colorado Office of Economic Development & International Trade, "Press Release: Advanced Industries Accelerator Grant Program Now Accepting Applications for Proof of Concept and Early Stage Grants (Jan. 5, 2018), available at https://choosecolorado.com/doing-business/advanced-industries/.

[xii] Vermont Department of Taxes, Hemp and Cannabidiol (CBD) Products, available at https://tax.vermont.gov/business-and-corp/industry-guidance/hemp-and-cbd (last visited Jun. 28, 2019).

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[xiii] Louisiana 2019 H.B. 560, Act 247 (eff. Jan. 1, 2020, imposing a three-percent excise tax on the retail sale of industrial hemp and cannabidiol products with revenue being dedicated to the state early childhood education fund). Full bill is available here: https://legiscan.com/LA/bill/HB560/2019 .

[xiv] Montana 2019 S.B. 178 (eff. Jan. 1, 2010), available at https://leg.mt.gov/bills/2019/BillHtml/SB0178.htm.

[xv] S. Dakota v. Wayfair, Inc., 138 S.Ct. 2080, 201 L.Ed.2d 403 (2018).

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