



Washington State  
**Liquor and Cannabis Board**

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**Date:** October 9, 2024

**To:** David Postman, Board Chair  
 Ollie Garrett, Board Member  
 Jim Vollendroff, Board Member

**From:** Daniel Jacobs, Policy and Rules Coordinator

**Copy:** Will Lukela, Agency Director  
 Toni Hood, Agency Deputy Director  
 Chandra Wax, Director of Enforcement and Education  
 Becky Smith, Licensing Director  
 Justin Nordhorn, Policy and External Affairs Director  
 Cassidy West, Policy & Rules Manager

**Subject:** **Approval to file a pre-proposal statement of inquiry (CR 101) regarding Employee Stock Ownership Plans (ESOP).**

The Washington State Liquor and Cannabis Board (Board) is considering amending [WAC 314-55-035](#) and other sections of Title 314 WAC, as well as repealing or creating other sections of Title 314 WAC as necessary to allow the use of Employee Stock Ownership Plans (ESOP) in connection with cannabis licenses in response to a petition for rulemaking [accepted](#) in May 2024.

**Process**

The Policy and Rules Coordinator requests approval to file the pre-proposal statement of inquiry (CR 101) for the rule making described above. A CR 101 Memorandum was presented at the Board meeting on October 9, 2024 and is attached to this order.

If approved for filing, the **tentative timeline** for the rule making process is outlined below:

October 9, 2024	Board is asked to approve filing pre-proposal statement of inquiry (CR 101). CR 101 is filed with the Office of the Code Reviser. Webpage is updated and notice circulated by GovDelivery distribution list. Informal comment period begins.
November 6, 2024	Notice is published in the Washington State Register under WSR 24-21.
November 9, 2024	Informal comment period ends.

December 16, 2024, 1 – 3 PM	Virtual Public Stakeholder Engagement Sessions
December 19, 2024, 10 AM - Noon	
January 15, 2025	Board is asked to approve filing proposed rules (CR 102). CR 102 is filed with the Office of the Code Reviser. Webpage is updated and notice circulated by the rules distribution list. Formal comment period begins.
February 5, 2025	Notice is published in the Washington State Register under WSR 25-03.
February 26, 2025	Public hearing held and formal comment period ends.
March 12, 2025	Board is asked to adopt rules if no substantive changes are made (CR 103). Concise Explanatory Statement is provided to individuals offering written or oral comment at the public hearing or during the formal comment period, consistent with RCW 34.05.325. CR 103 and adopted rules are filed with the Office of the Code Reviser. Webpage is updated and notice circulated by GovDelivery distribution list.
April 2, 2025	Notice is published in the Washington State Register under WSR 25-05
April 12, 2025	Rules are effective 31 days after filing unless otherwise specified. See RCW 34.05.380(2).

_____ Approve	_____ Disapprove	_____	_____
		David Postman, Chair	Date
_____ Approve	_____ Disapprove	_____	_____
		Ollie Garrett, Board Member	Date
_____ Approve	_____ Disapprove	_____	_____
		Jim Vollendroff, Board Member	Date

Attachments: CR 101 Memorandum  
May 22, 2024 Response to Petition for Rulemaking



## CR 101 Memorandum

### Re: **Employee Stock Ownership Plans (ESOP)**

Date: October 9, 2024

Presented by: Daniel Jacobs, Policy and Rules Coordinator

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### **Background**

During the 2023 legislative session, the Washington state legislature passed [Substitute Senate Bill 5096, chapter 392, Laws of 2023](#), expressing the policy of the state of Washington to support the use of Employee Stock Ownership Plans (ESOP) to encourage employee ownership structure.

An ESOP is a tax-qualified retirement plan that owns company stock and, through its corporate structure, gradually increases employee partial ownership of their employer as they obtain seniority, and should the employee leave the company or retire, they are able to trade in their shares and obtain a pot of money for retirement.

[WAC 314-55-035](#), known as the true party of interest (TPI) rule, identifies the permissible forms of corporate structure used in cannabis licenses, and depending on the structure, who or which entity needs to meet certain residency and other requirements of Washington law to participate in cannabis business ownership. [WAC 314-07-035](#) addresses similar requirements for liquor licensees.

In May 2024, the Washington State Liquor and Cannabis Board (LCB) [accepted](#) a petition for rulemaking from the Washington Cannabusiness Association to amend the TPI rule to explicitly identify ESOP as a permissible entity structure and who in relation to an ESOP would need to meet the TPI requirements.

### **Reasons Why Rulemaking Is Needed**

This rulemaking is needed to consider addressing explicitly allowing ESOPs to operate within existing Washington state cannabis statutes and regulations while preserving the intent of SSB 5096 by amending WAC 314-55-035 and other sections of Title 314 WAC and creating or repealing other sections of Title 314 WAC as necessary to respond to the rulemaking petition. This may include other rule changes needed to ensure ESOPs are not used to avoid compliance with other statutes and regulations. This rulemaking may also extend to the use of ESOPs regarding liquor licenses.

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## **Process**

The rulemaking process begins by announcing the Board's intent to consider changes to existing rules, adding new rule sections, or both, by filing a preproposal statement of inquiry (CR 101) form with the Office of the Code Reviser. This allows staff, stakeholders, industry partners, and all members of the authorizing environment to begin discussing proposed rule changes.

At this stage of the rulemaking process, no proposed language is offered. Any interested party may comment on this possible rulemaking during the designated comment period. Notice will be sent to all who have indicated that they want to receive notice of rule activity related to this preproposal statement of inquiry. The notice will identify the public comment period and where comments can be sent.

# PREPROPOSAL STATEMENT OF INQUIRY



## CR-101 (October 2017) (Implements RCW 34.05.310)

Do **NOT** use for expedited rule making

**Agency:** Washington State Liquor and Cannabis Board

**Subject of possible rule making:** Title 314 WAC. The Washington State Liquor and Cannabis Board (LCB) is considering amending WAC 314-55-035 and amending, repealing or creating new sections of Title 314 WAC as necessary to identify the conditions under which Employee Stock Ownership Plans (ESOP) may be permitted to have partial or complete ownership of cannabis licensees while complying with existing Washington statutes and regulations on true parties of interest and other laws relating to cannabis licenses. The rulemaking may extend to the permitted use of ESOP in liquor licenses.

**Statutes authorizing the agency to adopt rules on this subject:** RCW 66.08.030 (alcohol); RCW 69.50.342 (cannabis); RCW 69.50.345 (cannabis).

**Reasons why rules on this subject may be needed and what they might accomplish:** In May 2024, the LCB accepted a petition for rulemaking submitted by the Washington Cannabis Association requesting amendments to WAC 314-55-035 regarding true parties of interest to identify ESOP as a permissible entity for an ownership interest in a cannabis business in accordance with Washington statutes and regulations. This rulemaking may address explicitly allowing ESOPs to operate within existing Washington state cannabis statutes and regulations while preserving the intent of Substitute Senate Bill 5096, chapter 392, Laws of 2023, making it the public policy of the state of Washington to encourage the use of ESOP. The rulemaking may extend to the use of ESOP in liquor licenses as well. Other rule changes may be needed to ensure that ESOPs are not used to avoid compliance with other statutes and regulations.

**Identify other federal and state agencies that regulate this subject and the process coordinating the rule with these agencies:** None.

**Process for developing new rule (check all that apply):**

- Negotiated rule making
- Pilot rule making
- Agency study
- Other (describe) Collaborative rule making.

**Interested parties can participate in the decision to adopt the new rule and formulation of the proposed rule before publication by contacting:**

	(If necessary)
Name: Daniel Jacobs, Policy and Rules Coordinator	Name:
Address: PO Box 43080, Olympia, WA 98504	Address:
Phone: 360-480-1238	Phone:
Fax: 360-704-5027	Fax:
TTY:	TTY:
Email: rules@lcb.wa.gov	Email:
Web site: lcb.wa.gov	Web site:
Other:	Other:

Additional comments: Interested persons can participate in the rule process through open public meetings and by submitting written comments, and are encouraged to sign up for the interested parties list (GovDelivery) at <https://public.govdelivery.com/accounts/WALCB/subscriber/new>. Rulemaking notices and stakeholder engagement opportunities will be emailed via GovDelivery and posted to the LCB website at lcb.wa.gov.

<b>Date:</b> October 9, 2024	<b>Signature:</b> Place signature here
<b>Name:</b> David Postman	
<b>Title:</b> Chair	



## Washington State Liquor and Cannabis Board

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**Topic:** Petition for Adoption, Amendment, or Repeal of a State Administrative Rule – (WAC 314-55-035) Employee Stock Ownership Plans (ESOP)

**Date:** May 22, 2024

**Presented by:** Daniel Jacobs, Policy & Rules Coordinator

### **DISCLAIMER**

This response to a petition for adoption, repeal or amendment of a state administrative rule is drafted pursuant to [RCW 34.05.330](#) and [chapter 82.05 WAC](#). This is for general information purposes only and should not be construed as legal advice or individual advice for specific problems.

### **Background**

On March 26, 2024, Vicki Christopherson on behalf of the Washington Cannabusiness Association, submitted a petition for rulemaking to the Washington State Liquor and Cannabis Board (Board) requesting the Board initiate rulemaking to consider amending [WAC 314-55-035](#) to specifically contemplate an Employee Stock Ownership Plan (ESOP) business model for owning cannabis licensees and identify who and/or what in relation to an ESOP counts as a “true party of interest.”

Submitted with the Petition form was a letter included here:

This petition seeks to amend WAC 314-55-035 to (1) specifically contemplate cannabis businesses providing stock in their companies to their employees through Employee Stock Ownership Plans (ESOPs) and (2) establish who in a licensed business with an ESOP must be vetted as a “true party of interest.” Cannabis entrepreneurs should have the option of establishing an ESOP. Allowing Employee Stock Ownership Plans (ESOPs) as a viable option for cannabis businesses that brings new opportunities for both business owners and their valued employees.

Stock ownership is offered as a meaningful employee benefit in a variety of industries and could similarly be offered to cannabis employees. In addition to competitive salaries and comprehensive benefits, ESOP companies provide employees with unique wealth-building opportunities through stock ownership. This ensures that employees not only share in the success of the company but also have a pathway to financial security and prosperity. Stock ownership makes employees feel more a part of the success of the business and motivates performance.

ESOPs also benefit the companies that offer them. They serve as catalysts for enhanced employee engagement, paving the way for heightened productivity, innovation, and retention, all of which are vital for fostering superior business performance and sustainable growth. They also allow cannabis businesses to compete for talent in the workforce that may have a path to stock ownership in other industries.

Under the current rule, every employee with stock under an ESOP—no matter how small the percentage of ownership—would need to be vetted. This is simply impractical for the business, the employees, and the LCB. Therefore, who is a “true party of interest” must also be revised. The LCB can still ensure that the actual people that control the company—i.e., the larger shareholders and board/officers—are properly vetted and licensed.

The introduction of ESOPs for cannabis businesses represents a transformative opportunity to empower employees, foster job satisfaction, and promote long-term stability for cannabis businesses that choose to offer them. This can be accomplished with simple changes to the WAC while still preserving the integrity of true party of interest provisions and the LCB’s licensing mandate and processes.

## **Issue**

Whether the Board should accept the petition to initiate the rulemaking process to consider amending WAC 314-55-035 to address the ESOP ownership model and who and/or what needs to be vetted as a “true party of interest.”

## **Statutes & Regulations**

### ***Legislation***

Substitute Senate Bill 5096 ([chapter 392, Laws of 2023](#)) is known as the Expanding Employee Ownership Act and provided a statutory definition of “Employee Stock Ownership Plan” in Washington law.

### ***Statutes***

[26 USC § 280E](#) states that 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.

[26 USC § 4975\(e\)\(7\)](#) defines an “employee stock ownership plan” as a defined contribution plan which

- (A) which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a), and which are designed to invest primarily in qualifying employer securities; and
- (B) which is otherwise defined in regulations prescribed by the Secretary.

A plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409(h), section 409(o), and, if applicable, section 409(n) and



section 664(g) and, if the employer has a registration-type class of securities (as defined in section 409(e)(4)), it meets the requirements of section 409(e).

[RCW 69.50.342](#) identifies the rulemaking authority the Board has over matters related to cannabis.

[RCW 82.04.4488\(6\)\(c\)](#) states that "Employee stock ownership plan" has the same meaning as set forth in 26 U.S.C. Sec. 4975(e)(7), as of July 1, 2024.

**Regulations**

[WAC 314-07-035](#) is the true parties of interest rule for alcohol licensees.

[WAC 314-55-035](#) states that [a] cannabis license must be issued in the name(s) of the true party(ies) of interest. The board may conduct an investigation of any true party of interest who exercises control over the applicant's business operations. This may include financial and criminal background investigations.

[WAC 314-55-035\(1\)](#) states that [t]rue parties of interest must qualify to be listed on the license, and meet residency requirements consistent with this chapter. For purposes of this title, "true party of interest" means:

<b>Entity</b>	<b>True party(ies) of interest</b>
Sole proprietorship	Sole proprietor
General partnership	All partners
Limited partnership, limited liability partnership, or limited liability limited partnership	All general partners All limited partners
Limited liability company (LLC)	All LLC members All LLC managers
Privately held corporation	All corporate officers and directors (or persons with equivalent title) All stockholders
Multilevel ownership structures	All persons and entities that make up the ownership structure
Any entity(ies) or person(s) with a right to receive revenue, gross profit, or net profit, or exercising control over a licensed business	Any entity(ies) or person(s) with a right to receive some or all of the revenue, gross profit, or net profit from the licensed business during any full or partial calendar or fiscal year Any entity(ies) or person(s) who exercise(s) control over the licensed business
Nonprofit corporations	All individuals and entities having membership rights in accordance with the provisions of the articles of incorporation or bylaws

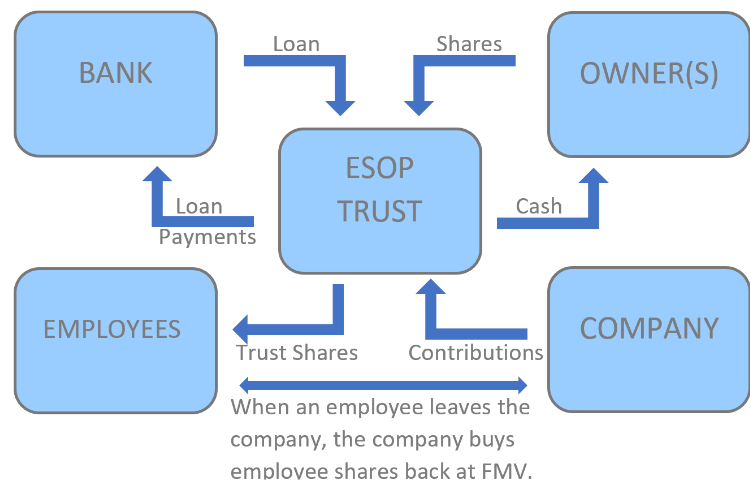
[WAC 314-55-035\(3\)\(b\)](#) defines a financial institution as any bank, mutual savings bank, consumer loan company, credit union, savings and loan association, trust company, or other lending institution under the jurisdiction of the department of financial institutions.

[WAC 314-55-035\(4\)\(g\)](#) states that, for purposes of this chapter, “true party of interest” does not include a financial institution.

## **Analysis**

During the 2023 legislative session, the Washington state legislature passed [Substitute Senate Bill 5096](#) (known as the Expanding Employee Ownership Act) which defines an Employee Stock Ownership Plan (ESOP) by pointing to a federal statute, 26 USC § 4975(e)(7), which in turn defines it as a stock bonus contribution plan that meets a whole host of federal requirements.

The below is a diagram of how the basic structure of the financial arrangements that create an ESOP work:



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In lay terms, an ESOP is a tax-qualified retirement plan that owns company stock.<sup>2</sup> A “sponsoring employer”, in this case, a cannabis licensee, will form an ESOP trust, and fund it, typically via loan. Those funds are used to buy the company’s shares, place them in the ESOP, along with annual financial contributions. Each year as the loan is paid down, the company adds shares pro rata to the employees’ ESOP accounts, based on how long they’ve been at the company. When an employee leaves, they get those shares held in the trust, which the company then buys from them at what is then fair market value

<sup>1</sup> Image copied from <https://www.wcl.american.edu/academics/experientialedu/clinical/theclinics/elc/tlcc/for-businesses-nonprofits/esops-info-sheet/#:~:text=An%20ESOP%20is%20an%20employee,flexibly%20out%20of%20the%20business>. (Last accessed 4/29/24)

<sup>2</sup> <https://www.cannabisbusinesstimes.com/news/esops-and-mewas-and-why-they-might-trend-in-cannabis/#:~:text=ESOPs%20are%20particularly%20hot%20in,from%20federal%20income%20tax%20and> (Last accessed 4/29/24).

(FMV). Thus, the longer the employee is at the company, the more shares they have in their ESOP trust account when they leave, and assuming each share is worth more by virtue of the company hopefully being worth more when they leave, this “retirement benefit” increases in value over time.<sup>3</sup>

Cannabis businesses, unlike all other businesses, are prohibited from deducting regular business expenses by 26 USC § 280E, which bars deductions for any business in the trade of “trafficking” in controlled substances as defined by the Controlled Substances Act, of which cannabis is still classified as Schedule I.

However, a company whose shares are entirely in an ESOP trust S-corporation (a closely-held entity that makes pass through elections on business incomes, deductions, credits etc., to its shareholders) is exempt from federal income tax. As such, an entity that is exempt from federal income tax does not need to worry about being barred from taking any federal income tax deductions, and thus can avoid the tax problems created by § 280E.

A quick online search of the terms “cannabis” and “ESOP” produces numerous results and recent news stories indicating that the avoidance of the § 280E tax burden is a primary motivating concern for cannabis businesses in their desire for ESOP formation.<sup>4</sup> This topic is even the subject of a webinar scheduled to occur the day before this petition response is scheduled to be presented.<sup>5</sup>

While several cannabis licensees have approached Board agency staff in various settings about whether an ESOP structure would be approved by the Licensing division, no ESOP structure has been formally submitted to Licensing for approval. Preliminary discussions identified concerns with the true party of interest (TPI) analysis, and what type of entity an ESOP trust would qualify as under WAC 314-55-035. While some licensees have suggested that an ESOP trust would qualify as a financial institution under WAC 314-55-035(3)(b), and therefore not a true part of interest under WAC 314-55-035(4)(g), this theory has not been tested in practice.

The primary concern lies in the ESOP structure where the participating employees have a degree of control through trust management documents that is required by federal regulations for proper tax treatment and consideration as an ESOP. However, this same level of control may trigger TPI questions and thus the possibility that every participating employee would need to meet TPI requirements, such as Washington state residency.

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<sup>3</sup> Id.

<sup>4</sup> <https://www.eisneramper.com/insights/cannabis/esops-cannabis-0324/> (Last accessed 4/29/24); <https://www.forbes.com/sites/dariosabaghi/2024/04/02/how-do-cannabis-employee-owned-companies-avoid-tax-burden/?sh=232e172c54e7> (last accessed 4/29/24); <https://www.greenmarketreport.com/theory-wellness-esop/> (last accessed 4/29/24).

<sup>5</sup> <https://www.dentons.com/en/about-dentons/news-events-and-awards/events/2024/may/21/cannabis-esops-why-an-esop-is-an-industry-game-changer> (Last accessed 4/29/24).

The petitioner seeks to clarify this position by requesting rule language stating that participating employees in an ESOP do not need to be vetted per the TPI process solely by virtue of their participation in an ESOP.

Licensing staff having already flagged concerns, accepting the petition does not necessarily predetermine that changes to the rule language in WAC 314-55-035 would or should occur. However, due to the complexity of this topic, and the overlapping regulatory authorities of state and federal agencies, further exploration of this possible entity structure and how it could potentially comply with existing Washington state cannabis regulations would best be done through the formal rulemaking process.

Having reached out to multiple state agencies that regulate financial entities, Director's office staff have learned that the Department of Revenue is in the process of implementing [SSB 5096](#) and should the Board decide to approve this petition, such rulemaking would need to coordinate with the Department of Revenue, and likely other agencies involved in SSB 5096, such as the Department of Financial Institutions, Department of Commerce, and potentially the Secretary of State.

It should be noted SSB 5096 identifies the legislative intent is to encourage the growth of employee ownership structures through this expanding employee ownership act.

### ***Divisional Coordination***

Licensing – The Licensing division notes that changing the rule as requested would be a large policy shift and would require updates to licensing processes, forms, and letters. Licensing is unsure how the division would verify certain statutory requirements such as [RCW 69.50.325](#) which limits ownership or control to no more than five retailers, [RCW 69.50.328](#) which prohibits any cross-tier direct or indirect financial interest, and [RCW 69.50.339](#) requiring the licensee to submit to the board and obtain approval of any stock ownership change more than ten percent. Should this petition be accepted, the Licensing division would like to have further discussions to understand how this change might impact the social equity program.

Enforcement & Education – The Enforcement & Education division identified several potential concerns resulting if this rulemaking were to proceed and with potentially changing the rule language as requested by the Petitioner. It could create a significant impact with hidden ownership investigations if all “owners,” “TPI” or other “vested” parties are not properly vetted into licensing requirements. This may create additional barriers in investigating a member of an ESOP regarding hidden ownership or undue influence under this new petition. Out of state and unvetted partial owners are already a concern and this rule change would add challenges in investigating this if they are not considered a “larger shareholder.”

Additional issues may be seen including money laundering using employee contributions and payments as layering, and undue influence by use of ESOP or the benefit of.

If rule changes are to be made to the TPI rule, the Enforcement & Education division would recommend amending WAC 314-55-035 to align it as closely with [WAC 314-07-035](#) as possible. The language used in any potential revisions should define that people exercising control over the business have to be vetted. If a managers or supervisors have significant shares and are exercising control, then those people should be vetted. WAC 314-07-035 currently includes much more detailed language about LLC members, TPIs, and privately held corporations that should be added to WAC 314-55-035.

Finance – no impacts on the Finance division immediately identified.

IT – no IT impacts immediately identified.

Public Health – no public health impacts have been identified that would result from this rulemaking, should the petition be accepted.

### ***Interagency Coordination***

Department of Financial Institutions (DFI) – will need to consult regarding implementation of SSB 5096.

Department of Revenue (DOR) – will need to consult regarding implementation of SSB 5096.

Department of Commerce (Commerce) – will need to consult regarding implementation of SSB 5096.

Department of Labor & Industries – no immediate impact identified.

Department of Health - no immediate impact identified.

Department of Agriculture – no immediate impact identified.

Department of Ecology – no immediate impact identified.

### ***Sovereign to Sovereign Consultations***

There has not been an immediate impact identified that may impact Tribal governments any more so than any other cannabis licensees. The tax consequences and considerations that provide much of the benefit to the ESOP structure may not be present with Tribal businesses.



### **Recommendation**

The Director's Office recommends the Board accept the rulemaking petition submitted by Vicki Christopherson on March 26, 2024. Given the complexity of the issues involved, it is likely rule language changes will be needed to allow for cannabis business to utilize

ESOP entity structure and still comply with existing Washington cannabis regulations. Accepting the petition for rulemaking does not necessarily mean the rule language will be changed as requested by the Petitioner. Further, it should be noted any rule development by LCB may be dependent upon other agency's rule development, therefore the opening of a CR 101 may be delayed.

**Board Action**

After considering the recommendation of Director's Office staff, the Board accepts/denies the petition for rulemaking submitted by Vicki Christopherson on March 26, 2024.

<input type="checkbox"/> Accept <input type="checkbox"/> Deny	<i>Not Present</i>	<u>5.22.2024</u>
	David Postman, Chair	Date
<input checked="" type="checkbox"/> Accept <input type="checkbox"/> Deny		<u>5.22.2024</u>
	Ollie Garrett, Board Member	Date
<input checked="" type="checkbox"/> Accept <input type="checkbox"/> Deny		<u>5.22.2024</u>
	Jim Vollendroff, Acting Chair	Date

Attachments:

- 1) Petition form and Letter from Petitioner