

BUSINESS

Minnesota's unique THC beverage industry threatened by marijuana legalization bill

Without a hemp-specific carve-out and other fixes, this uniquely Minnesota beverage market could be extinguished.

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The best-selling beverage at Fair State Brewing Cooperative these days is not a beer at all but a THC-infused seltzer, Chill State.

Since drinks and edibles with low doses of hemp-derived THC, the psychoactive component in cannabis, [became explicitly legal in Minnesota](https://www.startribune.com/minnesota-marijuana-hemp-cannabis-thc-delta-8-cbd-edibles-legal-new-law-legalization/600186748/) (<https://www.startribune.com/minnesota-marijuana-hemp-cannabis-thc-delta-8-cbd-edibles-legal-new-law-legalization/600186748/>) last summer, [dozens of brands have bubbled up across the state](https://www.startribune.com/minnesota-breweries-embracing-thc-beverages-here-are-10-to-try-cannabis-marijuana/600235676/) (<https://www.startribune.com/minnesota-breweries-embracing-thc-beverages-here-are-10-to-try-cannabis-marijuana/600235676/>). Breweries especially jumped at the chance to offer a novel non-alcoholic option — and shore up sales as craft beer's growth plateaus.

But Minnesota breweries and other hemp businesses are sounding the alarm over parts of a proposed [bill to legalize recreational marijuana in Minnesota](https://www.startribune.com/eight-takeaways-from-minnesota-democrats-marijuana-legalization-bill/600242310/) (<https://www.startribune.com/eight-takeaways-from-minnesota-democrats-marijuana-legalization-bill/600242310/>). If passed as introduced, the state's unique THC beverage market could evaporate.

"This has been a lifeline for many breweries," Fair State CEO Evan Sallee said. "I would not be surprised if some go out of business if this [bill] goes forward."

While THC beverages themselves would remain legal and subject to new licensing and regulatory scrutiny, the way in which most are currently produced and sold would need to drastically change.

"There are so many hurdles buried in the bill that it would essentially destroy the market for us," said Bauhaus Brew Labs president and co-founder Matt Schwandt, whose Tetra THC beverage now accounts for 5% of Bauhaus' sales.

GALLERY

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Same plant, different rules

The way hemp and marijuana are defined under federal law has far-reaching consequences for the state's THC beverage industry. Breweries and advocates say hemp-derived businesses need separate legislation or licensing than what has been proposed.

Gallery: Packing line operator Christopher Coughlin works quality control as Clr!ty THC infused seltzers are canned Thursday, Feb. 2, 2022 at the Fulton production brewery in northeast Minneapolis. Minnesota's fast-growing hemp-derived THC beverage business was legalized last summer.

HEMP	MARIJUANA
Federally legal	Federally illegal
Businesses can deduct expenses for federal taxes	Businesses cannot deduct expenses for federal taxes
Few issues with banking and card processing	Many banks and card processors refuse to work with marijuana

Yuqing Liu, Star Tribune

One concern is a requirement in the bill (https://www.revisor.mn.gov/bills/text.php?number=HF100&type=bill&version=2&session=ls93&session_year=2023&session_number=0) that "cannabis manufacturing must take place on equipment that is used exclusively for the manufacture of cannabinoid products."

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Critics say that would preclude all but the state's largest breweries or cideries from making their own beverages, assuming those bigger businesses would even want to invest in a second line of equipment they already own.

"There are very, very few breweries in the state of Minnesota that can justify two canning lines and two tanks and two pumps and two hoses," said Minneapolis Cider Company co-founder Jason Dayton. "Two of everything to be able to produce cannabis products and to continue to be able to produce their beers."

Minneapolis Cider's Trail Magic THC seltzers have been a boon for business, leading to additional investments in facilities and personnel, Dayton said. Some days, the cidery sells more THC drinks than it does alcohol.

Hemp vs. marijuana

The bill also creates potential tax and banking complications by combining marijuana and hemp in various definitions.

Federal law treats legal hemp and illegal marijuana differently (<https://www.startribune.com/what-exactly-is-hemp-derived-thc-and-how-is-it-different-from-marijuana/600208221/?refresh=true>), which helps explain why hemp-derived THC has been such a popular and profitable enterprise since the state Legislature clarified its legality (<https://www.startribune.com/minnesota-greenlights-small-doses-of-the-derived-from-legal-hemp/600176041/>) in Minnesota last year.

Marijuana businesses run into one of the [industry's most vexing issues](https://www.irs.gov/about-irs/providing-resources-to-help-cannabis-business-owners-successfully-navigate-unique-tax-responsibilities) (<https://www.irs.gov/about-irs/providing-resources-to-help-cannabis-business-owners-successfully-navigate-unique-tax-responsibilities>) — [IRS rule 280e](https://www.law.cornell.edu/uscode/text/26/280e) (<https://www.law.cornell.edu/uscode/text/26/280e>). The 40-year-old law states that a firm that has any involvement with federally illegal drugs cannot deduct business expenses, causing a higher tax bill that can be cost-prohibitive for small businesses. That's not currently the case with hemp businesses.

"That would be really detrimental to the hemp industry," said Steven Brown, head of the Minnesota Cannabis Association. "Our goal is for a marijuana bill that focuses on marijuana and a hemp-derived bill that would consist of licensing for retailers, manufacturers and wholesalers."

Minnesota Cannabis Beverage Association President Bob Galligan, who's also a lobbyist for the state Craft Brewers Guild, said most breweries will likely stick with hemp-derived THC products even if marijuana is legalized. That's because of the federal tax and banking issues associated with marijuana.

Most banks and credit card networks refuse to do business with marijuana companies because of the drug's federal illegality, forcing them to be cash-only. That problem won't go away if Minnesota legalizes marijuana at the state level.

"There's not quite as much of an actual legal uphill battle [with hemp]," Galligan said. "We want to maintain what we currently have and the ability to make and produce and sell these products."

Legislators said they are listening and will modify the bill's language to be friendlier to breweries.

"We'll fix this issue for the brewers," said Rep. Zack Stephenson, DFL-Coon Rapids, who's sponsoring the marijuana bill in the House. "I think the success of the THC-infused beverage industry is important to preserve. This has the potential to be a unique success story for Minnesota."

Alcohol alternative

No other state has a hemp-derived THC market quite like Minnesota's.

"It's extremely unique," said Matt Zehner, senior analyst with cannabis market insights firm Brightfield Group. "There's really no state that has tried to regulate [hemp THC] separately," other than to ban it.

Brightfield's consumer surveys show that many cannabis users decrease alcohol use, a potential threat to breweries.

"It's great to have opportunities for breweries to cash in on that, because it hurts alcohol sales," Zehner said. "There are a lot of people interested in alternatives to alcohol."

Sallee at Fair State, which recently launched the Chill State Collective to manufacture and distribute other cannabis brands, said offering THC beverages "just really broadens our reach."

"For whatever reason, a lot of people are deciding not to drink alcohol, so our low-dose beverage products can play an important social function," he said.

On the flip side, Zehner said the hemp-derived THC market, if preserved, could hurt Minnesota's potential recreational marijuana industry at the start. Lower production costs and consumer prices for hemp-derived products could keep prices for recreational marijuana products inflated for longer than typically happens as supply catches up with demand.

"It would be negative for the cannabis market but good for consumers at the same time," he said.

Brewery expertise

On Thursday, the canning line at Fulton's northeast Minneapolis production brewery was filling thousands of cans of Clr!ty THC seltzer, a product launched in August and now found at 600 bars, restaurants and retailers around the state.

Fulton packages a number of THC beverage brands, including its own, after gaining expertise making nonalcoholic hop water.

Brian Hoffman, co-founder and vice president of sales at Fulton, said breweries are adept at keeping equipment sterilized and preventing cross-contamination between batches of beer and THC beverages.

"We're able to plug it into our existing processes," he said.

Without changes to the adult-use cannabis bill, the current regulations around hemp-derived drinks and edibles would expire in summer 2024 and the new state licensing standards would kick in.

Clr!ty owner Scott O'Malley said his business will continue to grow regardless of the uncertainty. He's confident legislators will amend the bill and preserve the hemp-derived THC beverage industry in Minnesota.

"Frankly, 90-95% of these beverages are made at breweries right now," he said. "If we get this right, it will be the model other states want to have."

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