MAJOR MOVEMENT: HHS RECOMMENDS DEA RESCHEDULE MARIJUANA TO SCHEDULE III OF CONTROLLED SUBSTANCES ACT

September 5, 2023

By: Regulated Products Section Chair Richard Blau

Following a review initiated by the White House in October 2022, the U.S. Department of Human Health and Services (HHS) this week recommended that the Drug Enforcement Administration (DEA) reclassify marijuana from Schedule I to Schedule III of the Controlled Substances Act of 1970 (CSA). Schedule I drugs include drugs considered to have a high potential for abuse and no accepted therapeutic value, such as heroin and LSD. In contrast, Schedule III non-narcotic drugs are considered less addictive and harmful; examples include phendimetrazine, ketamine, and anabolic steroids such as Depo®-Testosterone.

Marijuana as a Source of "Accepted Therapeutic Value"

Marijuana has shown promise in relieving chronic pain. Moreover, scientists and medical researchers continue to explore marijuana as a possible treatment for cancer, post-traumatic stress disorder, and other conditions.

Perhaps the best evidence of medical efficacy is t that the U.S. Food and Drug Administration (FDA) approved Epidiolex (Greenwich Biosciences Inc, Carlsbad, Calif.), on June 25, 2018. Epidolex is the first plant-derived, purified pharmaceutical-grade cannabidiol (CBD) medication approved in the U.S. Although Epidiolex contains no Δ^9 tetrahydrocannabinol (Δ^9 THC), THC and CBD are considered phytocannabinoids, chemicals within cannabis that may interact with the cannabinoid receptor. Moreover, drug researchers have concluded that "both CBD and THC are thought to be efficacious in their role for pediatric epilepsy."

Because credible evidence exists that marijuana has "accepted therapeutic value," from a medical perspective, it logically qualifies for rescheduling to Schedule III. In that status, marijuana would be treated similarly to the way many states deal with state-legalized medical marijuana: requiring a

prescription from a qualified physician in accordance with drug regulations promulgated by the relevant government authority.

Rescheduling as a Boon to Research

Moreover, scientists and clinical researchers who study the effects of marijuana consumption have been stymied by the substance's Schedule I classification. A 2022 federal law, the Medical Marijuana and Cannabidiol Research Expansion Act, increased access to marijuana for medical research purposes; however, researchers must apply for a DEA license, which requires months of paperwork and must be repeated for each new study. Rescheduling would streamline the process. For example, a research manual published by the DEA states that researchers working with Schedule III substances are not required to submit their study protocols to the agency in advance.

Moving marijuana to Schedule III of the CSA also could increase the supply of cannabis for research. Currently, The DEA currently only permits a few universities and companies to produce the plant. Obtaining a permit means investing in a complicated security system and hiring trained guards. Researchers expect that rescheduling would ease strict security rules for storage and handling, which currently require high-tech lock boxes and security cameras.

Rescheduling as a Solution to the 280e Tax Conundrum

Despite expanding state legalization and the growing cannabis industry, the Internal Revenue Service (IRS) continues to deny business deductions for marijuana-related businesses (MRBs). Under Internal Revenue Code (IRC) § 280E, the IRS can disallow all ordinary and necessary business expenses by companies trafficking in illegal drugs.

Section 280E originated from a 1981 court case in which a convicted cocaine trafficker asserted his right under federal tax law to deduct ordinary business expenses. In 1982, Congress created 280E to prevent other drug dealers from following suit. It states that no deductions should be allowed on any amount "in carrying on any trade or business if such trade or business consists of trafficking in controlled substances."

The disallowance of ordinary and necessary business expenses greatly increases the costs of doing business for MRBs, especially for companies legally operating under state law. Federal income taxes generally are based on a straightforward formula: gross income, minus business expenses, yields taxable income. Owners of regular businesses often derive profits from these business deductions, which typically include expenses associated with production, processing, transportation, shipping, packaging, and weighing these substances. MRBs, however, pay taxes on total gross income without the ability to take any business deductions, which in some cases can result in tax rates that are 70% or higher.

Suppose the DEA reschedules marijuana as a Schedule III substance. In that case, it will still be a regulated substance subject to the regulations of the FDA, and differences will remain between marijuana's legal status at the state and federal levels for those states that legalize cannabis for adult recreational use. However, 26 U.S. Code § 280E makes clear that the barrier to business expense deductions applies to companies carrying on business or trade in Schedules I and II substances only:

> 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. (Added Pub. L. 97–248, title III, § 351(a), Sept. 3, 1982, 96 Stat. 640.)

Federal law makes clear that as a Schedule III substance, MRBs would pay less taxes because rescheduling would exclude marijuana from the barrier to business expense tax deductions currently imposed by IRC 280E.

Will it Happen?

Rescheduling marijuana will not solve all of the legal complexities resulting from the divide between the federal government and states, which are increasingly legalizing broader access to marijuana and other cannabis-derived products. Scheduled drugs require prescriptions and approval by the Food and Drug Administration (FDA). They could prove to be a regulatory challenge for the agency, which struggled for two years to develop regulatory guidance for the consumption of cannabis derivatives with marginal and incomplete success.

While positively viewed by the marijuana-related industry and many medical professionals, the HHS recommendation is nonbinding, and the DEA will make the final decision. Nevertheless, the recommendation from HHS is worth noting; in the past, the DEA often deferred to HHS on scientific and medical matters.

Richard M. Blau *leads the GrayRobinson Cannabis Law Team, focusing on the laws and regulations that govern the cultivation and production, processing, distribution, sale, and dispensing of medical marijuana, hemp, Cannabidiol (CBD), and related cannabis products. Richard has been rated by* ***Chambers and Partners*** *since 2007, was among the first lawyers in America to be rated Band 1 Nationwide for Cannabis Law, and is listed in* ***Best Lawyers® in America****. Richard has been involved extensively with the legalization of cannabis in Florida since its outset, with the passage of the Compassionate Medical Cannabis Act of 2014 (SB 1030) into law on June 6, 2014. Richard also has represented several investors in the cannabis industry, advising principals on compliance issues associated with Florida Medical Marijuana Treatment Center (MMTC) license acquisitions.*