

BIDEN ADMINISTRATION TO RESCHEDULE CANNABIS TO SCHEDULE III UNDER CONTROLLED SUBSTANCES ACT

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After some uncertainty since the move was first reported, the Biden administration officially announced that it will proceed with rescheduling cannabis from Schedule I to Schedule III under the Controlled Substances Act (“CSA”). Advocates for reform have applauded the move as a step in the right direction—though it does nothing to federally legalize cannabis. Prohibition advocates may file lawsuits if and when rescheduling rules are formally proposed. Assuming cannabis is successfully rescheduled, it will alleviate several legal burdens that have hindered the success of state-legal cannabis programs.

What is the CSA “Schedule”?

The CSA provides the statutory basis for federal regulation of a defined list of controlled substances. That list is stratified into five groups called “Schedules”—Schedule I through Schedule V. Substances are placed in one of the five Schedules based on determinations of their medical use, potential for abuse or addiction, and harmfulness. Schedule I includes the most dangerous substances with the least utility, and Schedule V includes most medically useful and/or least dangerous substances. For many decades, cannabis has been classified as a Schedule I controlled substance having no medical use and subject to high potential for abuse. Rescheduling to Schedule III is an acknowledgement of medical uses for cannabis and its comparatively low potential for abuse.

Federal Tax Benefits of Rescheduling

Rescheduling to Schedule III would have major impact on state-legal cannabis businesses. One impact will come in the form of tax relief concerning IRC Section 280E. Section 280E is the tax code provision which provides that illegal business enterprises still owe federal taxes and cannot deduct some of the major expenses ordinarily allowed to legal enterprises, such as rent or employee compensation. Critics of Section 280E argue it results in an oppressive burden that unfairly punishes state-legal cannabis businesses. Court challenges to Section 280E have been almost uniformly unsuccessful. However, Section 280E only applies to Schedule I and Schedule II substances. If cannabis is removed from Schedule I or II, it will no longer be subject to Section 280E, allowing state-legal cannabis businesses to take

Attorneys

Patrick Hines
Matthew Parker
Zoe Peppas

Practices & Industries

Cannabis & Hemp

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deductions for their ordinary business expenses for federal tax purposes.

Impact of Rescheduling on Available Financial Services

While cannabis has been listed in Schedule I, many providers of financial services such as banks, payment processors, and insurers are hesitant to do business with state-legal enterprises for fear of punishment by federal regulators. For example, last year Mastercard announced that it would no longer process debit card transactions for retail cannabis purchases. The lack of banking and other financial services has created headaches and increased cost of doing business for state-legal operators, who often must do business entirely in cash with associated security and other risks.

Legislative efforts to open financial services for state-legal operators have been unsuccessful. For example, the SAFER Banking Act, designed to give safe harbor for financial service providers who work with state-legal businesses, has floundered in Congress for years. Rescheduling cannabis through executive action would not solve the financial services problem, but it would clear the way for reform legislation such as SAFER.

When Will Rescheduling Become Law?

As with any rulemaking, federal law requires DEA to publish its proposed rule change in the Federal Register. After initial publication, there will be a public comment period and potentially an administrative hearing held by DEA officials. Once adopted as a final rule, the final rule will be published in the Federal Register and take effect after 30 days. All along the way, opponents to the change can potentially file lawsuits challenging the change. Even under a best-case scenario, the entire process can still take many months.

The Cannabis & Hemp attorneys at Hodgson Russ continue to follow developments in this cutting-edge area of federal and state law. If you have questions about how these changes may affect your business, contact the authors of this alert or any member of Hodgson Russ's [Cannabis & Hemp group](#).

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