

Cannabis remains an ‘industry interrupted’ without federal change

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DECEMBER 20, 2023

In August 2023, the cannabis industry received the biggest news yet on ending the federal prohibition of cannabis. In response to the Biden administration’s request to evaluate whether marijuana’s current Schedule I classification under the Controlled Substances Act (the CSA) was appropriate (White House, Oct. 6, 2022, Statement from President Biden on Marijuana Reform, <https://bit.ly/3Ps5lPB>), the U.S. Department of Health and Human Services (HHS) recommended reclassifying marijuana to Schedule III, a lower classification used for drugs with “a moderate to low potential for drug abuse.” (See, “US health officials look to move marijuana to lower-risk drug category” Reuters, Aug. 30, 2023, <https://reut.rs/47KXUuv>)

While this announcement was undoubtedly good news for the industry, many questions remain as to how a federal Schedule III classification could benefit, or further complicate, the struggling multibillion dollar industry. But will reclassification allow the industry to mature like other regulated industries or continue the uncertainty that perpetuates its stunted growth? Alas, an industry, interrupted.

Where we’ve been

The term “interruption” means to stop a continuation of progress. Over the past 50-plus years, starting with the founding of the National Organization for the Reform of Marijuana Laws (NORML) by Keith Stroup in 1970, cannabis advocates have slowly marched toward the reform of federal marijuana laws. While the movement started with the goal of ending the criminalization of cannabis, the passage of cannabis initiatives and legislation has evolved the “legalize it” movement into the development of a massive industry, national and international in scope.

Cannabis advocates and industry participants will tell you Schedule III is a drug classification they can live with, although it’s not ideal. With so few federal successes after half a century of trying, we will take what we can get. Reclassification to Schedule III will come with many desperately needed benefits for the industry, but also some (continued) costs.

280E gone for good?

If cannabis is reclassified to Schedule III, one of the biggest benefits to the industry will be the elimination of the applicability of I.R.C. 280E. So long as cannabis is not classified as Schedule I or II under the CSA, cannabis businesses will not be subject to 280E. This punitive tax

provision has greatly constrained the growth and profitability of cannabis businesses.

Without the impediment of 280E, cannabis businesses would be subject to ‘normal’ taxation of their actual realized income, allowing them to become more profitable, and consider each potential purchase, hiring decision, or investment in a different light. For example, a cannabis business may decide to provide an employee benefit which would have been a disallowed expense under 280E.

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The elimination of this punitive federal tax would also further diminish the black market, as many black-market participants only operate within it to avoid these unaffordable taxes and compliance costs, despite the criminal risks.

Pathways to commercial lending

Another roadblock which could disappear with federal reclassification is the current scarcity of banking, lending, and financing. Despite the size of the cannabis industry, banking remains costly and challenging, and traditional loans are virtually impossible to secure. The hope is that a lower-risk drug category will make more financial institutions receptive to offering cannabis businesses affordable and competitive accounts and loans on financially reasonable terms. Access to traditional lending will help cannabis businesses invest in growth and new opportunities.

In addition, a federal reclassification of cannabis may make the SAFER Banking Act (known as the Secure and Fair Enforcement Regulation Banking Act (<https://bit.ly/3t6Er8A>)) an easier pill to swallow for those voting in Congress on its ultimate passage. See also, “US Senate committee votes to advance marijuana banking bill,” Reuters Legal News, Sept. 27, 2023. (<https://reut.rs/3tndmf>)

Bankruptcy lifeline

Reclassification could allow the industry to access tools such as bankruptcy protection, an extraordinary tool for struggling businesses which allows distressed companies to preserve jobs and going concern value. So far, bankruptcy has been largely inaccessible as a result of numerous dismissals of any bankruptcy case involving cannabis related assets (Letter, U.S. Department of Justice, Executive Office for United States Trustees, April 26, 2017 (<https://bit.ly/47MnG1s>)).

However, notably, a recent case has signaled a possible retreat from this zero-tolerance policy. See also *In re The Hacienda Co., LLC*, BKY Case No. 2:22-bk-15163-NB [Dkt. No. 199], at 13 (Bankr. Sept. 20, 2023). While there is no guarantee federal bankruptcy courts will shift their approach, a reclassification of marijuana could make bankruptcy protections more available to cannabis businesses.

Interstate sales

Cannabis legally grown under state laws is not currently sold across state lines — even between states where it is legal — because interstate sales are prohibited. Most, if not all, state regulatory frameworks include ‘protectionist’ restrictions on out-of-state sales in an effort to avoid federal prosecution and enforcement.

But even here there is some movement. States like Washington have recently passed legislation which will automatically permit interstate sales if and when the federal prohibition on interstate sales of cannabis is lifted. (Gillette, Rachel, “Demystifying the dormant commerce clause’s consideration for cannabis,” *Reuters Legal*, Aug. 2, 2023.) The flow of product sales between states will transform the legal industry.

Product innovation

Federal reclassification will most certainly change the research landscape, which is currently overly restrictive given cannabis’s current Schedule I status. Loosening the restraints on research will likely foster the development of new products and lead to new innovations that benefit cannabis consumers.

Black market competition

Schedule III classification will allow the legal cannabis industry to offer some real competition to the black market. Punitive tax provisions such as I.R.C. 280E and state regulations implemented based on fear of federal enforcement come at a high price to state-legal cannabis companies.

About the author



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This article was first published on Reuters Legal News and Westlaw Today on December 20, 2023.

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Current prohibitions on interstate sales greatly restrict legal cannabis businesses’ ability to compete, allowing these markets to be dominated by black market sellers. It will be interesting to see the impact federal reclassification will have on the black market and its current consumers.

Federal conflicts will remain

Let’s not fool ourselves. A federal Schedule III classification under the CSA does not “legalize it” federally. Schedule III includes drugs such as ketamine and anabolic steroids, which last I checked, cannot be bought in a shop on Main Street.

As a Schedule III drug, cannabis will remain criminalized to some degree at the federal level and it will not be treated like other drugs which we already know have a high potential for abuse — alcohol and tobacco. Neither alcohol nor tobacco is considered a “controlled substance” under the CSA, which is why many advocates, such as Paul Armentano, the long-time Deputy Director of NORML, maintains that reclassifying cannabis to a lower CSA schedule continues to misrepresent its safety relative to other controlled substances, such as alcohol. (Norml Blog, “Rescheduling Marijuana is Not Enough,” Sept. 5, 2023).

In addition, because a Schedule III classification still means cannabis will be a federally regulated controlled substance under the CSA, it will not eliminate any of the existing conflicts between state and federal law.

Continued stunted growth?

Despite some federal glimmers of hope for the cannabis industry, like the SAFER Banking Act and the possible reclassification of cannabis, the federal government seems comfortable, if not intentional, in its desire to limit or slow the growth of the cannabis industry. Perhaps it is the intent because those in federal law enforcement, the executive branch, and Congress simply cannot get comfortable with federally legalizing and regulating cannabis similarly to other drugs not subject to the CSA, like alcohol and tobacco.

But should they get more comfortable? After all, the “head in the sand approach” has only allowed the black market to thrive and is simply out of touch with the public support for legalization. Gallup News, “Grassroots Support for Legalizing Marijuana Hits Record 70%,” Nov. 8, 2023. Almost half the states have legal adult-use cannabis laws (Ohio’s recent legalization makes it 24). Perhaps it is time to allow the industry to grow as it naturally would, unfettered and unrestricted by conflicting federal laws.