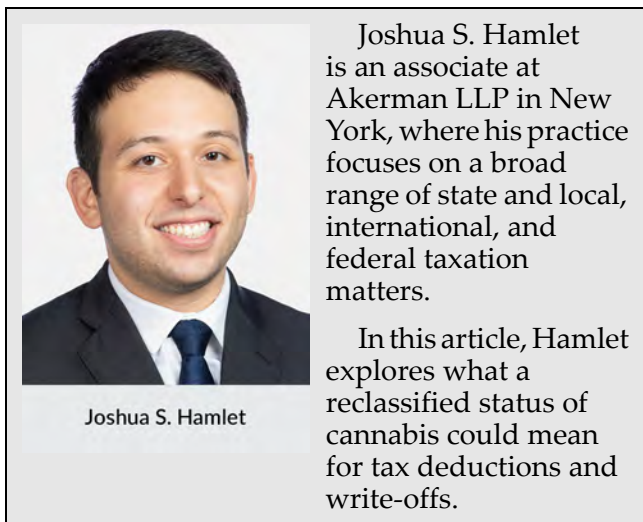


## Biden's Pardons Could Be a Big Win For the Cannabis Industry

by Joshua S. Hamlet



On October 6 President Biden announced pardons for those convicted of marijuana possession under federal law, as well as a review of the legal categorization of marijuana.<sup>1</sup> The president asked the secretary of Health and Human Services and the attorney general “to initiate the administrative process to review expeditiously how marijuana is scheduled under federal law.”<sup>2</sup> His statement continued: “Federal law currently classifies marijuana in Schedule I of the Controlled Substances Act [CSA], the classification meant for the most dangerous substances. This is the same schedule as for heroin and LSD, and even higher than the classification of fentanyl and methamphetamine — the drugs that are driving our overdose epidemic.”<sup>3</sup> If marijuana’s status is reclassified, that could possibly mean more tax deductions

for cannabis companies. So what does the legal classification have to do with tax write-offs?

### The History of the Controlled Substances Act

The CSA regulates the manufacture, importation, possession, use, and distribution of some substances. The act was signed by President Nixon in 1970 and placed all substances that were already regulated under existing federal law into one of five schedules.<sup>4</sup> The CSA established the following schedule, which can be amended by the Drug Enforcement Administration and the Food and Drug Administration.<sup>5</sup>

Now how do corporate tax deductions tie into this? Section 280E of the Internal Revenue Code, titled Expenditures in Connection With the Illegal Sale of Drugs, has caused confusion and frustration among cannabis businesses for years. The single-sentence provision states:

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.<sup>6</sup>

<sup>1</sup>The White House, Statement From President Biden on Marijuana Reform (Oct. 6, 2022).

<sup>2</sup>*Id.*

<sup>3</sup>*Id.*

<sup>4</sup>See P.L. 91-513 (1970).

<sup>5</sup>U.S. Drug Enforcement Agency, The Controlled Substances Act (Oct. 5, 2022).

<sup>6</sup>Section 280E (emphasis added).

	Potential for Abuse	Currently Accepted Medical Use	Potential for Addiction	Examples*
<b>Schedule I</b>	High	No	“There is a lack of accepted safety for use of the drug or other substance under medical supervision.”	<ul style="list-style-type: none"> <li>• Heroin</li> <li>• Lysergic acid diethylamide</li> <li>• Marijuana (cannabis)</li> <li>• 3,4-methylenedioxymethamphetamine (ecstasy)</li> <li>• Methaqualone</li> <li>• Peyote</li> </ul>
<b>Schedule II</b>	High	Yes; may be used with severe restrictions	“Abuse of the drug or other substances may lead to severe psychological or physical dependence.”	<ul style="list-style-type: none"> <li>• Combination products with less than 15 milligrams of hydrocodone per dosage unit (Vicodin)</li> <li>• Cocaine</li> <li>• Methamphetamine</li> <li>• Methadone</li> <li>• Hydromorphone (Dilaudid)</li> <li>• Meperidine (Demerol)</li> <li>• Oxycodone (OxyContin)</li> <li>• Fentanyl</li> <li>• Dexedrine</li> <li>• Adderall</li> <li>• Ritalin</li> </ul>
<b>Schedule III</b>	Less potential for abuse than substances in schedules I and II	Yes	“Abuse of the drug or other substance may lead to moderate or low physical dependence or high psychological dependence.”	<ul style="list-style-type: none"> <li>• Products containing less than 90 milligrams of codeine per dosage unit (Tylenol with codeine)</li> <li>• Ketamine</li> <li>• Anabolic steroids</li> <li>• Testosterone</li> </ul>
<b>Schedule IV</b>	Low	Yes	“Abuse of the drug or other substance may lead to limited physical dependence or psychological dependence relative to the drugs or other substances in Schedule III.”	<ul style="list-style-type: none"> <li>• Xanax</li> <li>• Soma</li> <li>• Darvon</li> <li>• Darvocet</li> <li>• Valium</li> <li>• Ativan</li> <li>• Talwin</li> <li>• Ambien</li> <li>• Tramadol</li> </ul>
<b>Schedule V</b>	Low	Yes	“Abuse of the drug or other substance may lead to limited physical dependence or psychological dependence relative to the drugs or other substances in Schedule IV.”	<ul style="list-style-type: none"> <li>• Cough preparations with less than 200 milligrams of codeine or per 100 milliliters (Robitussin AC)</li> <li>• Lomotil</li> <li>• Motofen</li> <li>• Lyrica</li> <li>• Parepectolin</li> </ul>

\*Source: U.S. Drug Enforcement Agency, Drug Scheduling (Oct. 5, 2022).

Since marijuana is classified as a Schedule I substance under the CSA, cannabis companies cannot deduct “ordinary and necessary” business expenses that are routine across other industries. In other words, cannabis businesses may only reduce their gross receipts by the cost of goods

sold in determining their gross income but may not take below-the-line deductions such as rents and salaries.

If Biden’s review triggers a reclassification of marijuana to a Schedule III, IV, or V substance, cannabis companies would be entitled to take the

same deductions as any other business. That would mean huge savings for the cannabis industry and much easier bookkeeping. If you listen, you can hear the sigh of relief from accountants everywhere. That's because deductions vary wildly based on whether the business operates as a grower or as a dispensary. If your business operations include both, the accounting can become extremely difficult.

### Previous Challenges to the CSA

So why is marijuana still classified higher than fentanyl and methamphetamine? Well, it's not for a lack of trying.

In 1973 John Kiffer, James Kehoe, and Robert Harmash challenged their convictions for possession of marijuana and claimed that the classification of marijuana as a Schedule I controlled substance under 21 U.S.C. section 812(c) was irrational and arbitrary.<sup>7</sup> Upholding the CSA, Second Circuit Judge Feinberg reasoned that because there was a dispute regarding the effects of marijuana, its placement as a Schedule I substance was not arbitrary or unreasonable enough to render it unconstitutional.<sup>8</sup> Feinberg wrote:

But the very existence of the statutory scheme indicates that, in dealing with this aspect of the “drug” problem, Congress intended flexibility and receptivity to the latest scientific information to be the hallmarks of its approach. This, while not necessary to the decision here, is the very antithesis of the irrationality appellants attribute to Congress.<sup>9</sup>

In 2018 a group of plaintiffs asserted an as-applied constitutional challenge to the CSA.<sup>10</sup> The crux of their argument was that “the current scheduling of marijuana violates due process because it lacks a rational basis.”<sup>11</sup> Relying on *Kiffer*, the U.S. District Court for the Southern

District of New York dismissed the claim, stating that “Congress had a rational basis to classify marijuana as a Schedule I drug.”<sup>12</sup>

These failed challenges have continued into this year. Casey Hardison was charged with three counts of delivery of a controlled substance (marijuana), and later filed a motion to dismiss the charges, claiming the Wyoming Controlled Substances Act (the state's adoption of the federal statute) was unconstitutional “by operating in an unequal and disparate manner because tobacco and alcohol are excluded from its application.”<sup>13</sup> However, in April the Wyoming Supreme Court held that the act did not deny Hardison equal protection of the law under the U.S. Constitution.<sup>14</sup>

Justice Gray's opinion relied on precedent in similar cases, all holding that Congress is not required to take an all-or-nothing approach regarding drug regulation.<sup>15</sup> To put it simply, Congress chose to include a classification for marijuana, but the CSA just happens to be silent on tobacco and alcohol. Congress cannot possibly classify every harmful substance. Since it was analyzed under the rational basis test,<sup>16</sup> unfortunately for Hardison, deference is granted to the legislators. However, he may be in luck if he qualifies for Biden's pardon.

Even though Feinberg believed that the CSA should be updated based on the latest scientific information, the courts do not seem to be interested in the science. Judge Hellerstein, who wrote the opinion for *Washington v. Sessions*, highlighted the conflict between scientific evidence and the law:

I emphasize that this decision is not on the merits of plaintiffs' claim. Plaintiffs' amended complaint, which I must accept as true for the purpose of this motion, claims that the use of medical marijuana has, quite literally, saved their lives. One plaintiff in this case, Alexis Bortell, suffers from intractable epilepsy, a severe

<sup>7</sup> *United States v. Kiffer*, 477 F.2d 349 (2d Cir. 1973).

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Washington v. Sessions*, 17 Civ. 5625 (AKH) (S.D.N.Y. Feb. 26, 2018).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Hardison v. State*, 2022 WY 45, 507 P.3d 36 (Wyo. 2022).

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

seizure disorder that once caused her to experience multiple seizures every day. After years of searching for viable treatment options, Alexis began using medical marijuana. Since then, she has gone nearly three years without a single seizure. Jagger Cotte, another plaintiff in the case, suffers from a rare, congenital disease known as Leigh's disease, which kills approximately 95 percent of those afflicted before they reach the age of four. After turning to medical marijuana, Jagger's life has been extended by two years and his pain has become manageable. I highlight plaintiffs' experience to emphasize that this decision should not be understood as a factual finding that marijuana lacks any medical use in the United States, for the authority to make that determination is vested in the administrative process. In light of the decision of the Second Circuit, *see United States v. Kiffer*, 477 F.2d at 355-57, and the several decisions of the D.C. Circuit, *see, e.g., Am. for Safe Access*, 706 F.3d at 449, I am required to dismiss plaintiffs' rational basis claim.<sup>17</sup>

Scientific evidence may qualify marijuana as a Schedule III substance based on the current scheduling criteria. However, it could also qualify as a Schedule II substance, depending on your definitions of *abuse*, which is notably not defined in the CSA, and whether the medicinal use of marijuana comes with severe restrictions. Fortunately for cannabis businesses, the current guidelines suggest marijuana would fall under

Schedule III, or even possibly Schedule IV. Ketamine is classified as a Schedule III substance, but ketamine therapy appears to have more severe restrictions than obtaining a medical marijuana card.<sup>18</sup>

### The Future of Section 280E

There is still no guarantee that marijuana will be reclassified as a lower-schedule substance. The criteria for the schedules can always be amended, politics and lobbying will always play important roles, and even if it is ultimately reclassified, it likely will not be any time soon.

However, the reclassification looks promising. Health and Human Services Secretary Xavier Becerra said he's looking forward to working with Attorney General Merrick Garland to answer the "call to action" on marijuana scheduling. There are already multiple decriminalization bills in Congress, such as the Marijuana Opportunity Reinvestment and Expungement Act (H.R. 3617), which passed the House in April, and the Cannabis Administration and Opportunity Act (S. 4591), which was introduced in the Senate in July.<sup>19</sup>

But for now, tax practitioners will have to continue wrestling with section 280E and all the complications that arise as a result. Since the October 17 tax filing deadline extension recently passed, cannabis companies will have to go another tax season without eligibility for those below-the-line deductions . . . but it might be a good idea for them to start saving their receipts for next year. ■

<sup>18</sup> Cf. American Psychiatric Nurses Association, Ketamine Infusion Therapy Treatment Considerations ("Ketamine therapy should only be considered after failure of standard treatment: No sustained change following adequate antidepressant trials [some individuals will have tried several different anti-depressants], different medication combinations, and/or ECT/TMS") with Georgia Access to Medical Cannabis Commission, Frequently Asked Questions ("Q: How can I obtain a Low-THC Oil Registry Card in Georgia? A: Patients register with the Georgia Department of Public Health after consulting with a doctor or physician."); and Utah Department of Health, Apply for a Patient Card ("Locate a medical provider who is registered to recommend medical cannabis.").

<sup>19</sup> Wesley Elmore, "Biden Review of Marijuana Scheduling Could Have Tax Implications," *Tax Notes Federal*, Oct. 7, 2022, p. 272.

<sup>17</sup> *Washington v. Sessions*, 17 Civ. 5625 (AKH), at 7.