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**HIGH EXPECTATIONS: WHAT RESCHEDULING MARIJUANA
COULD MEAN FOR THE CANNABIS INDUSTRY**

❖ Note ❖

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I. INTRODUCTION

On January 12, 2024, the U.S. Department of Health and Human Services (HHS) released a review addressed to the U.S. Department of Justice’s Drug Enforcement Administration (DEA) that recommended marijuana (*Cannabis sativa* L.) be rescheduled from Schedule I to Schedule III of the Controlled Substance Act.¹ The unredacted recommendation was released as a result of the effort of Matthew Zorn, who filed a Freedom of Information Act complaint against HHS in September 2023.² Zorn announced the recommendation would be released on January 11, 2024 on his blog, writing: “I win . . . Impossible just takes a few weeks.”³ The release of this recommendation is a win not only for Zorn and people who enjoy the drug recreationally, but for the U.S. cannabis market, which was valued at \$13.2 billion in 2022.⁴

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¹ Letter from Rachel Levine M.D., Assistant Secretary for Health, U.S. Public Health Service, to Anne Milgram, Administrator, Drug Enforcement Administration, U.S. Department of Justice (Aug. 29, 2023) (on file with the Department of Health and Human Services). Under 21 U.S.C. § 811, the Attorney General must request the Secretary provide a scientific and medical evaluation and their recommendation as to whether “a drug or other substance should be so controlled or removed as a controlled substance” before the Attorney General may transfer between or remove a controlled substance from its schedule.

² Compl. at 6, *Zorn v. United States Health & Human Services*, No. 1:23-CV-02894 (D.D.C. Sept. 29, 2023).

³ Matthew Zorn, *Update on HHS FOIA Litigation, ON DRUGS* (Jan. 11, 2024), <https://ondrugs.substack.com/p/update-on-hhs-foia-litigation>.

⁴ U.S. CANNABIS MARKET SIZE, SHARE & TRENDS ANALYSIS REPORT BY END-USE (MEDICAL, RECREATIONAL, INDUSTRIAL), BY SOURCE (MARIJUANA, HEMP), BY DERIVATIVE (CBD, THC), AND

As a Schedule I drug, marijuana is not approved for medical use by the federal government. Schedule I drugs, substances, or chemicals under the CSA are defined as having no currently accepted medical use with a high potential for abuse.⁵ Marijuana’s current scheduling has resulted in a cannabis industry that has to navigate through a hazy legal environment to avoid going up in smoke.⁶

One legal hurdle for cannabis businesses is 26 U.S.C. § 280E (§ 280E). This section prohibits businesses that traffic “controlled substance (within the meaning of Schedule I and II of the Controlled Substances Act)” from deducting ordinary and necessary business expenses from their taxes.⁷ This means that cannabis businesses must carefully structure their company to avoid being taxed on their gross income, which could be financially devastating.⁸ However, if the DEA follows the HHS’s recommendation to reschedule marijuana as a Schedule III controlled substance, companies would no longer be subject to § 280E.⁹ Further, rescheduling would mean cannabis businesses that handle the “plant-touching” side of the industry would no longer have to be a separate and distinct business, reducing compliance headaches in addition to the newly deductible expenses.¹⁰

To this end, Part II of this Note discusses the history of § 280E and its current status in states that have legalized medicinal and recreational marijuana use, and it explores the contents of the Secretary’s letter to the Attorney General. Part III analyses the tax, M&A, FDA compliance, and banking implications that may arise as a result of marijuana becoming a Schedule III-controlled substance. Part IV recommends how cannabis companies should respond to this schedule change, focusing on defending their foothold in the emerging market.

SEGMENT FORECASTS, 2023 – 2030, GRAND VIEW RSCH. (2022), <https://www.grandviewresearch.com/industry-analysis/north-america-legal-marijuana-market>.

⁵ 21 U.S.C. § 812.

⁶ Amanda Hernández, *Varying State Marijuana Rules Cause Confusion Amid Ongoing Federal Prohibition*, MARIJUANA MOMENT (July 8, 2023), <https://www.marijuanamoment.net/varying-state-marijuana-rules-cause-confusion-amid-ongoing-federal-prohibition/>.

⁷ 26 U.S.C. § 280E.

⁸ Thomas Firestone, et al., *Who’s Afraid of Code Sec. 280E?*, TAXES THE TAX MAG. 7 (2021), <https://www.bakermckenzie.com/-/media/files/people/kroll-ethan/taxes-whos-afraid-of-code-sec-280e-november-2021.pdf?la=en>.

⁹ Iran Hopkins, *Cannabis Under Federal Law—What’s the Fuss About Section 280E?*, BLOOMBERG TAX (Apr. 21, 2022), <https://news.bloombergtax.com/tax-insights-and-commentary/cannabis-under-federal-law-whats-the-fuss-about-section-280e>.

¹⁰ *Id.*

II. BACKGROUND

A. *A Legal Buzzkill: The History of Section 280E*

When Congress disagrees with the United States Tax Court’s ruling on a legal issue, it may enact a new law to override the Tax Court.¹¹ The Internal Revenue Code provides that when determining taxable income, gross income refers to “all income from whatever source derived,” which includes income from businesses.¹² Taxable income can be minimized through deductions as specified by the Code.¹³ 26 U.S.C. § 162(a) allows businesses to deduct all “ordinary and necessary expenses paid” during the tax year.¹⁴ Such ordinary and necessary expenses include salaries, travel expenses, and rental payments.¹⁵ To prevent criminal activity from benefitting from the tax code, 26 U.S.C. § 162(c)(2) disallowed deductions for any “illegal payment under any law of the United States . . . which subjects the payor to a criminal penalty”¹⁶ Prior to 1982, however, the Code did not address the issue of whether an illegal business could deduct their *legal* business expenses.

In its 1981 decision, *Edmondson v. Commissioner of Internal Revenue*, the United States Tax Court ruled an illegal business’s legal expenses were deductible under 26 U.S.C. §§ 161 and 162.¹⁷ Jeffrey Edmondson, a consignor of amphetamines, cocaine, and marijuana, claimed the cost of goods sold and expenses of his consignment business on his Federal income tax return.¹⁸ The Tax Court held his deductions, including “[a portion of his rent], a small scale, packaging expenses, telephone expenses, and automobile expenses,” were ordinary and necessary business expenses made in connection to his business.¹⁹ This decision was delivered eleven months before President Ronald Reagan declared a national war on drugs.²⁰ As a response to

¹¹ David Butter, *Modernizing U.S. Tax Code Section 280e: How an Outdated “War on Drugs” Tax Law Is Failing the United States Legal Cannabis Industry and What Congress Can Do to Fix It*, 14 FIU L. REV. 739, 751 (2021) (“In direct response to *Edmondson v. Commissioner*, a case that had been decided before the United States Tax Court in 1981, the drafters of the 1982 Tax Code parted ways with the 1969 Tax Code and turned the focus of deductibility to the legality of the business itself.”).

¹² 26 U.S.C. § 61(a)(2).

¹³ *Id.* § 161.

¹⁴ *Id.* § 162(a).

¹⁵ *Id.*

¹⁶ *Id.* § 162(c)(2).

¹⁷ *Edmondson v. Comm’r*, 42 T.C.M. (CCH) 1533 (1981).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ President Ronald Reagan, *Remarks Announcing Federal Initiatives Against Drug Trafficking and Organized Crime at the Department of Justice* (Oct. 14, 1982), <https://www.reaganlibrary.gov/archives/speech/remarks-announcing-federal-initiatives-against-drug-trafficking-and-organized-crime>.

the growing cultural movement against drugs and to close this loophole, Congress passed § 280E in 1982.²¹

Section 280E disallows deductions or credits on any business that traffics schedule I or II controlled substances prohibited by Federal law.²²

Even in states where growing and distributing marijuana is legal, § 280E prohibits lawful cannabis businesses from deducting legal ordinary and necessary business expenses from federal taxable income.²³ Cannabis businesses must be careful to keep the “plant-touching” side of their business separate from other services.²⁴ The Internal Revenue Service requires businesses to document distinct revenue streams in order to establish separation between their purposes to provide marijuana and their other services.²⁵ Two cases involving two California cannabis businesses illustrate the business organization tactics that can impact what the Tax Court will recognize as a deduction under § 280E:

The first business, Californians Helping to Alleviate Medical Problems (CHAMP), was a charitable corporation whose members, after paying a monthly fee, were given access to caregiving services and medical marijuana.²⁶ CHAMP’s services were meant for the terminally ill: forty-seven percent of members suffered from Acquired Immune Deficiency Syndrome and the remaining members suffered from cancer, multiple sclerosis, and other serious illnesses.²⁷ In addition to educating members on how to safely use medical marijuana, CHAMP also provided personal and group counseling, organized social events, and hosted educational classes.²⁸ They advertised these services in addition to providing low-income members with lunch and computer access.²⁹ Because of the extensive services provided, the Court reasoned CHAMP’s primary purpose was to provide services to the terminally ill, not to provide marijuana.³⁰ Thus, the Court held CHAMP was involved in “more than one trade or business,” and CHAMP’s caregiving services could be deducted under § 280E.³¹

The second business, Vapor Room, was a marijuana lounge that provided community-oriented services to its clients.³² Vapor Room set its business up like a “community center,” providing complimentary activities (games, books, and art

²¹ Douglas Khan and Howard Bromberg, *Provisions Denying a Deduction for Illegal Expenses and Expenses of an Illegal Business Should Be Repealed*, 18 FLA. TAX REV. 207, 214 (2016).

²² 26 U.S.C. § 280E.

²³ *Id.*

²⁴ Firestone, *supra* note 8 at 7.

²⁵ *Id.*

²⁶ *Californians Helping to Alleviate Med. Problems, Inc. v. Comm’r*, 128 T.C. 173, 175 (2007).

²⁷ *Id.* at 174.

²⁸ *Id.* at 175.

²⁹ *Id.*

³⁰ *Id.* at 184.

³¹ *Id.*

³² *Olive v. Comm’r*, 792 F.3d 1146, 1148 (9th Cir. 2015).

supplies), drinks (tea and water), snacks (including pizza and sandwiches), and services (massages, yoga, and movies) to patrons.³³ Customers could purchase medical marijuana from Vapor Room at varying prices depending on their ability to pay.³⁴ Vapor Room's staff freely counseled customers on various personal, legal, or political matters related to medical marijuana in addition to educating customers on how to safely use medical marijuana.³⁵ However, the Ninth Circuit Court of Appeals held that Vapor Room was only involved in one business: selling medical marijuana.³⁶ The Court distinguished Vapor Room's activities from CHAMP's, reasoning that while CHAMP's member fee went to supplying medical marijuana *and* services, Vapor Room provides patrons with these services at no fee in order to entice customers into purchasing medical marijuana.³⁷ Vapor Room, the Court concluded, was excluded from deducting the ordinary and necessary expenses from these services under § 280E.³⁸

Under § 280E, cannabis businesses must carefully structure their businesses to comply with federal law.³⁹ As the Vapor Room in *Olive v. Commissioner* demonstrates, creative approaches to get around § 280E are high risk and likely not to succeed in the Tax Court.⁴⁰ Cannabis businesses currently must utilize attorneys and cannabis accountants in order to avoid prohibitively high income taxes.⁴¹ Table 1 shows a simple example of how businesses calculate gross profit and net income. However, as Table 2 demonstrates, cannabis businesses which do not properly structure their organization are taxed at a far greater rate under § 280E. Business A, a non-cannabis business, is taxed based on its net income for that tax year (\$300,000). Business B, a cannabis business, however, is taxed based on its gross income under § 280E (\$1,400,000). After federal income taxes, Business A's net profit is \$237,000. Business B's net profit after federal income taxes is \$6,000. (Table 2). If a cannabis business does not carefully structure its business, a company could easily pay taxes that exceed its net income.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 1149.

³⁷ *Id.* at 1150.

³⁸ *Id.* at 1151.

³⁹ Firestone, *supra* note 9 at 7.

⁴⁰ Olive, 792 F.3d at 1151.

⁴¹ Firestone, *supra* note 9 at 7.

Table 1. Example of Gross Profit and Net Income Calculation⁴²

Revenue	\$2,000,000
Cost of Goods Sold	- \$600,000
Gross Profit	\$1,400,000
Other Selling, General, & Administrative Expenses	- \$1,100,000
Net Income	\$300,000

Table 2. The Disparate Impact of § 280E on Cannabis Businesses⁴³

	Business A (Non-Cannabis Business)	Business B (Cannabis Business)
Gross Profit	\$1,400,000	\$1,400,000
Net Income	\$300,000	\$300,000
Taxed Income	\$300,000	\$1,400,000
Federal Income Tax Owed (Rate 21%)	\$63,000	\$294,000
Net Income after taxes	\$237,000	\$6,000
Effective Tax Rate	21%	98%

B. Cannabis's Evolving Status in State and Federal Law

In most states, the state income tax scheme closely resembles the federal tax base.⁴⁴ Currently, forty-three states and the District of Columbia levy individual income taxes while only seven (Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming) have no state individual income tax.⁴⁵ Forty-four states levy a corporate income tax, ranging from 2.5% in North Carolina to 11.5% in New

⁴² See Adam Prest, *How Section 280E Creates Big Tax Challenges For The Cannabis Industry*, ANDERS CPA + ADVISORS (Sept. 8, 2023), <https://anderscpa.com/how-section-280e-creates-big-tax-challenges-for-the-cannabis-industry/?tag=cannabis>.

⁴³ *Id.*

⁴⁴ Andriy Blokhin, *State Income Tax vs. Federal Income Tax: What's the Difference?*, INVESTOPEdia (Jan. 30, 2023), <https://www.investopedia.com/ask/answers/060515/what-difference-between-state-income-tax-and-federal-income-tax.asp>.

⁴⁵ Timothy Vermeer, *State Individual Income Tax Rates and Brackets, 2023*, TAX FOUND. (Feb. 21, 2023), <https://taxfoundation.org/data/all/state/state-income-tax-rates-2023/>.

Jersey, while other states impose a gross receipt tax, and three states impose both a gross receipt and a corporate income tax.⁴⁶ Only two states, South Dakota and Wyoming, levy neither a corporate income nor gross receipts tax.⁴⁷ Of the states which do impose individual and corporate income taxes, their tax codes “conform to the federal tax base by incorporating federal definitions of income.”⁴⁸ While this conformity helps states reduce the administrative costs of creating, interpreting, and adjudicating unique tax codes, it also means the majority of states’ income tax base reflect the federal government’s policies and incentives.⁴⁹ For legal cannabis businesses, state parity of federal tax law means that there is no reprieve from § 280E. In 2022, “cannabis operators paid over \$1.8 billion in additional taxes when compared to ordinary businesses.”⁵⁰

While § 280E has historically wreaked havoc on cannabis operators’ taxable income, states where marijuana is legal have begun to change their tax codes. As of 2024, twenty of the of the twenty-four states which have legalized marijuana allow cannabis business expenses to be deducted.⁵¹ In 2023, for example, the Illinois legislature passed a revision to the Illinois Income Tax Act that allowed any cannabis establishment, cultivation center, or medical cannabis dispensing organizations to deduct an “amount equal to the deductions that were disallowed under Section 280E of the Internal Revenue Code for the taxable year.”⁵² These changes are certainly a boon for the industry, but the potential windfall of rescheduling cannabis from schedule I to schedule III would be even more beneficial.

C. You Can’t Spell Healthcare Without THC: A Brief Explanation of the HHS’s Letter to the DOJ

Calls for rescheduling marijuana under the CSA are not new. Petitions for marijuana’s rescheduling began in 1986 and continue today.⁵³ What is new, however, is that the federal government seems closer than ever to rescheduling marijuana. In

⁴⁶ Janelle Fritts, *State Corporate Income Tax Rates and Brackets, 2023*, TAX FOUND. (Jan. 24, 2023), <https://taxfoundation.org/data/all/state/state-corporate-income-tax-rates-brackets-2023/>.

⁴⁷ *Id.*

⁴⁸ Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267, 1275 (2013).

⁴⁹ *Id.*

⁵⁰ Whitney Economics, *Economic Analysis Indicates Cannabis Industry Paid \$1.8 Billion in Excess Taxes in 2022*, PR NEWSWIRE (May 8, 2023), <https://www.prnewswire.com/news-releases/economic-analysis-indicates-cannabis-industry-paid-1-8-billion-in-excess-taxes-in-2022--301817848.html>.

⁵¹ *States Allowing State-Legal Cannabis Business Expenses Deductions Despite 280E*, MARIJUANA POL’Y PROJECT, <https://www.mpp.org/issues/legalization/states-allowing-state-legal-cannabis-business-expenses-deductions-despite-280e/>.

⁵² 35 ILL. COMP. STAT. ANN. 5/203 (2023).

⁵³ Schedules of Controlled Substances: Rescheduling of Synthetic Dronabinol in Sesame Oil and Encapsulated in Soft Gelatin Capsules From Schedule I to Schedule II; Statement of Policy, 51 Fed. Reg. 17,476 (May 13, 1986) (to be codified at 21 C.F.R. pt. 1308).

the HHS's letter to the DEA, Rachel Levine recommended marijuana should be placed in Schedule III of the CSA based on the HHS's collected evidence and the Food and Drug Administration's recommendation.⁵⁴

When considering the scheduling of marijuana under the CSA, the HHS evaluated eight factors: (1) marijuana's actual or relative potential for abuse; (2) the scientific evidence of marijuana's pharmacological effect; (3) the state of current scientific knowledge regarding marijuana; (4) marijuana's history and current pattern of abuse; (5) the scope, duration, and significance of abuse; (6) what, if any, risk there is to the public health; (7) the psychic or physiological dependence liability; and (8) whether marijuana is an immediate precursor of a substance already controlled.⁵⁵ This inquiry concluded that marijuana has less potential for abuse than other drugs in Schedules I and II, marijuana has a currently accepted medical use in the United States, and marijuana's abuse may lead to only "a moderate or low physical dependence or high psychological dependence."⁵⁶ Altogether, the medical and scientific findings led the Secretary to recommend marijuana be rescheduled to Schedule III. As the Attorney General has been provided evidence and the Secretary's recommendation, marijuana's rescheduling may be imminent.⁵⁷

The DOJ has recently signaled it is considering whether to reschedule marijuana.⁵⁸ In its memorandum in support of a motion to dismiss complaint filed on January 23, 2024, the DOJ's attorneys wrote, "the DEA is currently considering HHS's recommendation to reschedule marijuana."⁵⁹

Scheduling marijuana to Schedule III means cannabis companies will no longer be subject to § 280E. Beyond this tax benefit, this would likely also change the M&A, FDA compliance, and banking strategies of cannabis establishments, cultivation centers, and medical cannabis dispensing organizations.

III. ANALYSIS

A. Tax Considerations

The most obvious result of rescheduling marijuana to a Schedule III-controlled substance is that cannabis organizations would be able to deduct their ordinary and necessary business expenses from their federal income taxes. As a Schedule-III controlled substance, marijuana would no longer be subject to § 280E. Rescheduling would also simplify the structure of cannabis businesses in relation to

⁵⁴ Letter from Rachel Levine M.D., *supra* note 1.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ 21 U.S.C. § 811.

⁵⁸ Mem. in Supp. of Mot. to Dismiss Compl., 3 n.1, *Canna Provisions, Inc. v. Garland*, No. 23-CV-30113 (D. Mass. Jan. 23, 2024).

⁵⁹ *Id.*

“plant-touching.” However, this change in cannabis tax law does not mean that cannabis businesses are in the clear. After rescheduling, cannabis businesses would then be exposed to a tidal wave of new tax laws.

This section will provide an overview of potential tax considerations for cannabis businesses in the event marijuana is rescheduled to a Schedule III-controlled substance. It is important to note that this is an incomplete list, and that as a Schedule III-controlled substance, marijuana would still be highly regulated under federal law. First, “plant-touching” cannabis businesses would be able to deduct state and local taxes from their federal income tax. Under the State and Local Tax (SALT) Deduction, small businesses may deduct up to \$10,000 of itemized property, sales, or income taxes already paid to state and local governments.⁶⁰ Local cannabis dispensary businesses, like Vapor Room, could take advantage of this law to minimize federal income taxes. Second, cannabis companies would be able to take advantage of federal tax credits for businesses.⁶¹ These tax credits include work opportunity credits, which incentivize hiring from targeted groups such as veterans and ex-felons.⁶² 26 U.S.C. § 38 also includes federal tax credits for investment, research, and clean energy—categories that many cannabis businesses would likely qualify for if they were not subject to § 280E.⁶³ Third, if marijuana is rescheduled to Schedule III, cannabis growers may be classified as farmers under the Internal Revenue Code and qualify for farmer-specific tax deductions.⁶⁴ Someone is “in the business of farming if [they] cultivate, operate, or manage a farm for profit, either as owner or tenant. A farm includes . . . plantations, ranches, ranges, and orchards and groves.”⁶⁵ A cannabis farm would likely qualify as a plantation or an orchard. California’s Department of Cannabis Control describes cannabis cultivator’s product as a “flower” and the area where mature plants are grown as the “canopy.”⁶⁶ Plants that are cultivated for their flowers include chamomile, lavender, and sunflowers. These types of farms qualify under the Internal Revenue Code as a farm, as these flowering plants are grown in orchards.⁶⁷ The Code’s farmer-specific tax deductions include deductions for fertilizer and lime as well as up to seventy-five percent of their farm equipment expenses, in addition to their other personal and business expenses.⁶⁸ However, cannabis growers would still be subject to federal law

⁶⁰ 26 U.S.C. § 164(b)(6)(B).

⁶¹ *Id.* § 38.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ FARMER’S TAX GUIDE FOR USE IN PREPARING 2023 RETURNS, DEP’T OF THE TREASURY 1 (2023), <https://www.irs.gov/pub/irs-pdf/p225.pdf>.

⁶⁵ *Id.*

⁶⁶ *Cultivation*, CAL. DEP’T OF CANNABIS CONTROL, <https://cannabis.ca.gov/licensees/cultivation/#:~:text=Cultivators>.

⁶⁷ Guido van der Hoeven, *Farm, Farming and Who’s a Farmer for Tax Purposes*, RURAL TAX EDUC., 4 (2022), <https://www.farmers.gov/sites/default/files/2022-03/whos-a-farmer.pdf>.

⁶⁸ *Id.*

requirements for Schedule III-controlled substances. While the federal government has currently elected not to prioritize enforcing federal laws prohibiting cannabis, it may choose to treat cannabis operators differently after rescheduling to ensure they comply with Schedule III-controlled substance laws.

B. Investment, Growth, and Banking Reform: The SAFER Banking Act and Beyond

In recent years, cannabis M&A activity and capital investment has declined.⁶⁹ Between 2021 and 2022, the North American cannabis market experienced a sixty-eight percent decrease in the total value of cannabis capital raised and a seventy-three percent decrease in the total value of mergers and acquisitions (M&A) activity.⁷⁰ This decline in the market was not unexpected.⁷¹ The increase in cannabis sales in 2020 and 2021 due to the COVID pandemic were outliers for the industry.⁷² Additionally, pro-cannabis initiatives which initially excited investors, like the SAFER Banking Act, a bill which would protect federally regulated financial institutions that serve state-sanctioned marijuana businesses, are still stuck in the political process.⁷³ This lack of political movement and capital decline likely means investors are currently reluctant to enter the cannabis market.⁷⁴

Rescheduling marijuana may be just the sign investors need to enter the cannabis industry. Though there has been a decline in the M&A and financing market, the US legal cannabis market increased by twenty-three percent in 2022.⁷⁵ Rescheduling probably will result in an even greater boon to business. First, because cannabis would no longer be illegal federally, banks will be able to knowingly accept and do business with funds from the cannabis industry.⁷⁶ Thus, the lack of political will to pass the SAFER Banking Act will be a moot issue. Post-rescheduling, cannabis businesses will have easier access to mortgages, deposit accounts, insurance, and other normal business financial services.

Second, rescheduling cannabis will likely increase access to prescriptions for medical marijuana. Schedule III-controlled substances are defined as having less

⁶⁹ *The Cannabis Capital Flow – 2022*, VIRIDIAN CAP. ADVISORS, LLC (2023), https://assets.ey.com/content/dam/ey-sites/ey-com/en_ca/topics/cannabis/ey-cannabis-coe-viridian-report-fy-2022-v07-final.pdf.

⁷⁰ *Id.*

⁷¹ Isaac Bock, *Consolidation in Cannabis: What's Happening With Mergers and Acquisitions?*, ALPHAROOT (Sept. 26, 2023), <https://alpharoot.com/insights/consolidation-in-cannabis/>.

⁷² *Id.*

⁷³ SAFER Banking Act of 2023, S.2860, 118th Congress (2023).

⁷⁴ See *The Cannabis Capital Flow*, *supra* note 69.

⁷⁵ *Id.*

⁷⁶ The sale of cannabis is illegal federally. Under 18 U.S.C. § 1956, an institution that is knowingly involved in a financial transaction that represents the proceeds of some form of unlawful activity may be sentenced to a fine of not more than \$500,000 or twice the value of the property involved in the transaction.

potential for abuse than Schedule I or II substances.⁷⁷ They also have an acceptable medical use within the United States.⁷⁸ Due to these reasons, these substances undergo less federal regulation than Schedule I-controlled substances.⁷⁹ This includes federal regulations regarding their manufacture, distribution, and dispensation.⁸⁰ Prescriptions for Schedule III-controlled substances may be written, orally communicated, or faxed to the pharmacy and refilled up to five times in a six-month period.⁸¹ Although rescheduling marijuana federally would not legalize states' recreational marijuana laws, it would federally legalize the medical usage of marijuana. This would drastically expand the market of patients with access to a legal source of medicinal marijuana.

These changes to the cannabis market will likely increase interest in publicly traded companies, such as Trulieve Cannabis Corp, Curaleaf Holdings, and Green Thumb Industries. The pace of M&A will also likely increase, as federal legalization may result in a greater push for vertical integration.⁸² Consolidating multiple types of cannabis businesses together, such as agriculture, biotechnology, consumption devices, and real estate will likely be easier in a post-280E world and would allow companies to “stabilize the cost from seed to sale.”⁸³

IV. RECOMMENDATION

A. Keep Excise Taxes Low

Following marijuana's likely rescheduling to Schedule III, the federal government and state governments should refrain from increasing excise taxes prohibitively high. An excise tax is “[a] tax imposed on the manufacture, sale, or use of goods (such as a cigarette tax), or on an occupation or activity (such as a license tax or an attorney occupation fee).”⁸⁴ Excise taxes are often placed on products the government wants to reduce consumption of, like cigarettes.⁸⁵ However, when these

⁷⁷ 21 U.S.C. § 812(3).

⁷⁸ *Id.*

⁷⁹ See Nicole R. Ortiz and Charles V. Pruess, *Controlled Substance Act*, in STATPEARLS (2024), [https://www.ncbi.nlm.nih.gov/books/NBK574544/#:~:text=The%20Controlled%20Substance%20Act%20\(CSA,and%20use%20of%20regulated%20substances.](https://www.ncbi.nlm.nih.gov/books/NBK574544/#:~:text=The%20Controlled%20Substance%20Act%20(CSA,and%20use%20of%20regulated%20substances.)

⁸⁰ 21 U.S.C. §§ 821-832.

⁸¹ *Id.*

⁸² Bock, *supra* note 71.

⁸³ *Id.*

⁸⁴ *Tax*, BLACK'S LAW DICTIONARY (11th ed. 2019).

⁸⁵ Adam Hoffer, *Cigarette Taxes and Cigarette Smuggling by State, 2020*, TAX FOUND. (Dec. 6, 2022), <https://taxfoundation.org/data/all/state/cigarette-taxes-cigarette-smuggling-2022/>.

excise taxes get too high, smuggling rates often increase.⁸⁶ Take, for example, the negative impact of cigarette smuggling as a result of increased excise taxes.⁸⁷

In 2019, Illinois increased its cigarette excise tax to \$2.98, an increase of a dollar.⁸⁸ Nearby states Indiana, Iowa, Kentucky, and Wisconsin saw an increase in outbound smuggling.⁸⁹ As a result, in 2020, net cigarette smuggling had increased in Illinois by fourteen percent, resulting in an estimated loss of \$334 million in cigarette taxes.⁹⁰ More disturbingly, as the excise tax on cigarettes increased, there was an increase in cigarette smuggling through “illicit international channels.”⁹¹ Illinois not only lost millions of dollars in tax revenue, but cigarettes coming through illegal channels pose a serious health risk to its citizens. “[C]ounterfeit cigarettes can have as much as seven times the lead of authentic brands and close to three times as much thallium, a toxic heavy metal.”⁹² Untaxed and unregulated cigarettes hurt legal markets, state revenue, and public health. Many consumers turn to black market products to avoid these excise taxes.

Policymakers should learn a lesson from the tobacco industry when considering how to implement an excise tax on marijuana. Undoubtedly, marijuana use is a negative public behavior; however, as it is better for public health than cigarettes, it should not get the same treatment by policymakers.⁹³ Most consumers want to buy goods from legal sources rather than the black market, as they can trust the product and know the product will be of a high quality.⁹⁴ By keeping excise taxes low, policymakers can incentivize consumers to purchase marijuana legally. This would provide more consistent revenue for the state and federal government and reduce the risk to the public health that may result from ingesting unregulated marijuana.

B. Cannabis Companies: Defend Your First-Mover Advantage

As discussed in Part III, rescheduling marijuana will likely benefit the cannabis industry.⁹⁵ By lowering the risk of entering the marijuana market, more companies and small businesses will likely be willing to enter. However, this new

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ Robert Melamede, *Cannabis and Tobacco Smoke Are Not Equally Carcinogenic*, 2 HARM REDUCTION J. 1, 4 (2005).

⁹⁴ Mike Adams, *Cannabis Consumers Prefer Legal Sources to Black Market*, CHICAGO TRIBUNE (Aug. 30, 2019), <https://www.chicagotribune.com/2019/08/30/cannabis-consumers-prefer-legal-sources-to-black-market/>.

⁹⁵ See discussion *supra* Part III.

interest in the market might negatively impact companies already in the industry if their foothold in the market is not solidly grounded. To avoid losing out in this emerging market, companies should “aggressively defend their first-mover advantage.”⁹⁶ They can do so by “building scale, creating a global footprint, and establishing barriers to entry by protecting proprietary technology or ideas” in the emerging cannabis market.⁹⁷

V. CONCLUSION

It is likely that the DEA will follow HHS’s recommendation to reschedule marijuana to a Schedule III-controlled substance soon.⁹⁸ While this is an obvious step in the right direction for cannabis organizations, not being governed by § 280E will likely result in a drastic change in tax law, cannabis business structure, and investor interest. Cannabis is a massively profitable industry within the United States and is projected to keep growing.⁹⁹ If the DEA decides to reschedule marijuana to a Schedule III controlled substance, the federal government and state governments should be sure to adopt pro-business tax practices to encourage continued cannabis business investment in the state.

⁹⁶ Graeme Deans, Fritz Kroeger, and Stefan Zeisel, *The Consolidation Curve*, HARV. BUS. REV. <https://hbr.org/2002/12/the-consolidation-curve>.

⁹⁷ *Id.*

⁹⁸ Mem. in Supp. of Mot. to Dismiss Compl., 3 n.1, *Canna Provisions, Inc. v. Garland*, No. 23-CV-30113 (D. Mass. Jan. 23, 2024).

⁹⁹ U.S. *Cannabis Market Size*, *supra* note 4.