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Biggest impact of Biden cannabis order may be on taxes

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Cannabis dispensaries pay extraordinarily high tax rates compared to regular businesses because federal law does not permit them to take standard business deductions. But if cannabis is rescheduled from Schedule 1 to a Schedule 3 drug or below, those taxes would be eliminated, legal experts say.

The biggest impact of President Joe Biden's order to review how cannabis is scheduled under federal law may be on taxes.

Cannabis dispensaries pay extraordinarily high tax rates compared to regular businesses because federal law does not permit them to take standard business deductions.

Last year, a 9th U.S. Circuit Court of Appeals panel rejected an appeal by an Oakland cannabis dispensary arguing U.S. Code Section 280E is unconstitutional. *Patients Mutual Assistance Collective Corp. v. Commissioner of Internal Revenue* (9th Circ., filed Dec. 4, 2019).

But if cannabis is rescheduled from Schedule 1 to a Schedule 3 drug or below, those taxes would be eliminated, legal experts say.

"It solves the tax problem," said James B. Mann, a Lucosky Brookman partner who represented Harborside Health Center in its unsuccessful challenge to the tax code.

"Reducing an effective tax rate to standard corporate tax rates would be astronomical for the industry," Sander C. Zagzebski, co-leader of Clark Hill LLP's Cannabis Industry Group, said in a phone interview.

But it's possible the Biden administration could reschedule cannabis to a Schedule 2 drug, similar to fentanyl or methamphetamine, which would maintain the same high tax rate. Legal and political observers also said it would take a long time for Biden's administrative process, led by Attorney General Merrick Garland and U.S. Secretary Health and Human Services Xavier Becerra, to complete its administrative review.

While the president instructed Garland and Becerra to move "expeditiously," no one expects any rescheduling to occur for another two or possibly three years. Depending on the length of the process, there could be a new president by then.

Cannabis dispensaries and marijuana advocates have been hoping for relief from the federal government ever since Biden was elected president and Democrats took narrow control of Congress. They have been disappointed thus far, and shares in publicly held U.S. cannabis companies have plummeted since February 2021, even before the overall stock market swooned and marijuana sales flattened this year.

A legislative proposal to ease banking regulations has passed in the U.S. House of Representatives several times, with bipartisan support, but the bill — known as the SAFE Act — has stalled in the U.S. Senate. The legislation could be considered after the midterms.

Cannabis advocates also have hoped that legislation or executive branch action could allow publicly traded companies, currently traded only in Canada and on U.S. over-the-counter markets, to uplist to the New York Stock Exchange or Nasdaq.

Zagzebski said a move to Schedule 2 would probably not allow cannabis companies to be listed on mainstream U.S. stock exchanges. Those exchanges "fear aiding and abetting liability under the Controlled Substances Act and worry about other regulatory compliance issues like money laundering," he wrote in an email.

A bipartisan bill, the CLIMB Act, was introduced in Congress in June to allow U.S. cannabis companies to uplist. Ideally, cannabis industry advocates hope not for rescheduling under the Controlled Substances Act but descheduling, so marijuana would be treated like alcohol.

But legal experts say such a move would be complicated due to U.S. treaty obligations and almost certainly cannot be done by Biden alone.

"Congress has to be involved" in any decision to deschedule cannabis, Mann said.

Other legal experts, however, said rescheduling cannabis is probably something that can be done by the administration without congressional approval.

"Federal law currently classifies marijuana in Schedule I of the Controlled Substances Act, the classification meant for the most dangerous substances," the president's Thursday statement said. "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."

Fentanyl and methamphetamine are both categorized under Schedule 2 of the Controlled Substances Act, and the president's statement implies that cannabis should not be treated like those narcotics.

Mann takes a skeptical view of Biden's announcement, which occurred a month before the November midterm elections, and called it "preelection pandering."

But after months of grim news, Biden's surprise announcement cheered investors in cannabis companies, which shot up between 24% and 50% Thursday before falling a bit in mixed trading on Friday.

Legal experts say, regardless of the motive, a serious consideration of the scheduling of marijuana is long overdue, especially given the inconsistency between federal law — which still treats the drug as illegal — and most state laws — which allow medicinal or recreational use.

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