

Insights: Publications

Cannabis Rescheduling (I to III): Truth v. Fiction

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The news has been a flurry of information and excitement following confirmed reports that the U.S. Drug Enforcement Administration (“DEA”) will soon propose a new rule to reschedule cannabis from a Schedule I controlled substance to a Schedule III controlled substance under the Controlled Substances Act (“CSA”). This follows a long period of anticipated action after President Biden directed the Department of Health and Human Services (“HHS”) and his Attorney General Merrick Garland to conduct a thorough review of the scheduling of cannabis in October 2022 and the more recent recommendation of HHS for a rescheduling directed at the DEA back in August 2023. While it is not officially in the books, the rescheduling process is likely to get started very soon, as the Presidential election nears.

You will read and hear a lot of information about what all of this means over the coming days and months. Some of the news will be confusing and maybe even contradictory. For now, here is an overview of the most critical aspects to help inform and educate you on what is expected to be a well-covered rescheduling process... the first for cannabis after more than 50 years on the CSA.

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This is just the very beginning of the rescheduling process. TRUTH

As of today, May 1, 2024, the official rescheduling process has not formally started. Settle in, because here are the complicated and lengthy steps, briefly:

- Office of Management and Budget will kick it off with an official approval to remove marijuana from Schedule I (*goodbye to Schedule I mates heroin and LSD*) and to place it in Schedule III (*with ketamine and steroids*).
- The DEA will then accept public comments on the proposed move.
- Following the public comment period, there will be a review by an administrative law judge.
- After all of this, including some likely litigation, the DEA will finally publish the final rule confirming the rescheduling.

The rescheduling process is essentially a rubber stamp that will fly through. FICTION

The full rescheduling process is going to take some time. Expect 12-18 months. While there is significant support around the country, with 38 states having a legalized medical cannabis program and 24 states with a legalized adult-use program, there are still critics who believe that rescheduling should not happen.

The primary rescheduling benefit for licensed cannabis operators is the elimination of the 280E tax burden. TRUTH

Under the IRS Code, Section 280E, Schedule I and II substances are prohibited from deducting their ordinary business expenses, causing companies to carry nearly 70% effective tax rates. However, this tax burden does not apply to Schedule III and the converted opportunity for cannabis companies to operate as other mainstream businesses with business expense tax deductions will allow the industry to grow in many ways that it could not before.

Rescheduling will make cannabis legal under federal law. FICTION

The proposal will not be for a full de-scheduling of cannabis from the Controlled Substances Act. Moving from Schedule I to Schedule III still keeps the cannabis plant on the list of federally illegal substances. Thus, the current challenges stemming from the inconsistencies of state-legal jurisdictions and the still illegal federal law will remain in place. State legal cannabis operations, whether medical or adult use, will continue to be at odds with federal law.

Schedule III means that cannabis is now recognized as having a medical benefit. TRUTH

Schedule III includes substances defined as having moderate potential for abuse (less than Schedules I or II) and having a currently accepted medical use. This new definition for the cannabis plant, under Schedule III, should have a significant impact on the ability of companies to research the plant and expand the potential pathways to FDA approvals of cannabis focused medicine.

(a) A rescheduling will extinguish state-based operators. FICTION

(b) A rescheduling will legalize state-based operators. FICTION

There will be no automatic change to the state regulatory programs by a rescheduling of cannabis, one way or the other. In fact, the elimination of the Section 280E tax burden will actually help the state-based operators and programs overall. Moreover, it would be expected that remaining states without legal programs will be more likely to enact legalization following the federal government's clear message of a loosening of the grip on cannabis.

There is still much to learn in the coming months and years as to how rescheduling will actually affect the industry in various ways. TRUTH

Still to be determined: while Schedule III still defines cannabis as illegal at the federal level (i) will more banking and lending opportunities open up, (ii) will the federally based bankruptcy and patent/trademark protections become more accessible, (iii) will pharmaceutical companies participate in the industry more aggressively with the medical nod from the Feds?

Conclusion

As usual in the cannabis industry, we will hurry up and wait. At the very least, our federal government has now taken its first major step to advance the cannabis industry in the right direction.

As we proceed through this process, I welcome your input, so do not hesitate to reach out to me with questions, suggestions, and thoughtful ideas. You can also learn more about Kilpatrick's Cannabis Practice [here](#).

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