Will Rescheduling Cannabis Open the Industry to Increased Financing, Real Estate and Banking Opportunities?

Client Alert

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What You Need to Know

- Following the Department of Justice's proposal to reschedule cannabis as a Schedule III controlled substance, the cannabis industry awaits a final outcome following a period of public comment.
- Although rescheduling would result in significant tax benefits to industry members, the manufacturing, distribution and possession of cannabis would remain illegal at the federal level.
- For members of the financial and real estate sectors, careful consideration on a case-by-case basis will be required when evaluating potential business opportunities.

By: Jack Fersko

On May 16, 2024, the U.S. Department of Justice (DOJ) issued its proposed rules to transfer cannabis from Schedule I of the Controlled Substances Act (CSA) to Schedule III of the CSA. The DOJ's proposal follows the U.S. Department of Health and Human Services' determination that cannabis has an accepted medicinal value and low abuse potential, yielding a recommendation for the rescheduling of cannabis to Schedule III. The DOJ's Office of Legal Counsel issued an opinion that generally supports the rescheduling proposal.

A 60-day public comment period commenced on May 21, 2024 (when the rules were published in the Federal Register) and will end on July 22, 2024. Rescheduling awaits the outcome of those public comments and the final determination of the DOJ and the Drug Enforcement Administration (DEA).

There are some clear business benefits to rescheduling, including that if rescheduled to Schedule III, the restrictions of Section 280E of the Internal Revenue Code (IRC) will no longer apply. Section 280E precludes businesses from taking business deductions if engaged in a business involving controlled substances under Schedule I and II of the CSA. The cannabis industry has thus far been limited to deductions for the cost of goods sold. Rescheduling will enable cannabis businesses to significantly reduce taxable income by opening up deductions for rent, wages and other traditional business expenses. This should have a positive impact on both debt and equity financing, and on a landlord's assessment of a prospective tenant's profitability and ability to satisfy rental obligations.

According to a recent article published in *Ganjapreneur*, however, the American Bankers Association stated on April 30, 2024, that even if cannabis is rescheduled to Schedule III, the passage of SAFER Banking legislation by Congress will be critical in order for traditional financial services to be available to state licensed cannabis facilities. It was further reported that although approximately 675 financial institutions conduct business with the cannabis industry nationwide, the scope of those services is not clear - are those financial institutions limited to accepting deposits or are they providing loans and other credit facilities?

In addition, rescheduling cannabis will not legalize it at the federal level. Products containing cannabis must still receive approval from the Food and Drug Administration. Thus, the manufacturing, distribution and possession of cannabis will continue to be a crime at the federal level, leaving a gap between federal governmental and state-level medicinal and adult use laws. As such, interstate commerce will continue to be barred, and questions will remain with respect to the availability of federal bankruptcy and intellectual property protections. In addition, cannabis industry participants (operators, investors and landlords) must continue to assess the impact of wide-ranging state laws and regulations in evaluating any activity in this business arena.

While rescheduling (if it comes to fruition) will be welcomed by the cannabis industry, financing, real estate and banking businesses will have to continue their careful scrutiny of each individual business opportunity.

Related Attorneys

Jack Fersko

Partner

732.476.3354

Email