



Docket No. DEA-1362: Comment on Proposed Rulemaking

Prepared for: **Anne Milgram**
Administrator, U.S. Drug Enforcement Administration

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Administrator Milgram:

On behalf of Reason Foundation, we thank you for accepting these comments and making them part of the public record. Reason Foundation is committed to ensuring that states implement effective regulation of marijuana markets in order to protect public health and safety while also fostering competition to offer genuine entrepreneurial opportunities to individuals from a range of backgrounds.

We applaud President Joe Biden for requesting the Drug Enforcement Administration (DEA) to initiate a rescheduling hearing for marijuana on October 6, 2022. We are further pleased with the review of scientific literature subsequently undertaken by the U.S. Department of Health and Human Services (HHS) that resulted in a series of binding conclusions that marijuana has accepted medical use and holds lesser potential for abuse than other substances currently listed in Schedules II under the Controlled Substances Act (CSA). The Attorney General's Office of Legal Counsel has advised that any requirements imposed by international treaties to which the United States is party to make a substance contraband cannot supersede the scheduling procedures set forth elsewhere in the Controlled Substances Act. In other words, the DEA holds impeded authority to determine the proper scheduling of marijuana pursuant to the criteria set forth in 21 U.S.C. 811(a) through (c). HHS has recommended marijuana be moved to Schedule III, and we are commenting on the DEA's regulatory hearing to consider this recommendation.

The DEA has specifically solicited public input on the possible "unique economic impacts" of rescheduling, given that "marijuana is subject to a number of State laws that have allowed a multibillion dollar industry to develop." Reason Foundation has published extensive research on the possible economic impacts of moving marijuana to Schedule III and is uniquely positioned to inform this request by DEA.¹

Federal Income Taxes and Financial Services

For cannabis companies, the most visible effect of moving marijuana from Schedule I to Schedule III would be that persons or businesses involved in the sales, manufacture, or distribution of marijuana would no longer be subject to provisions of Internal Revenue Code Section 280E, nor to provisions of

¹ Michelle Minton, "The Implications of Federal Cannabis Rescheduling," Reason Foundation policy brief, January 2024, <https://reason.org/wp-content/uploads/the-implications-of-federal-cannabis-rescheduling.pdf>.

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the PATRIOT Act and other federal anti-money laundering laws that specifically apply to those trafficking in substances listed under Schedules I and II of the CSA.

Specifically, IRC Code 280E prevents a federal taxpayer that traffics a Schedule I or II substance from claiming deductions for business expenses under the “ordinary and necessary” standard that applies to most federal taxpayers. Instead, federal taxpayers trafficking in these substances may only deduct expenses directly related to the production or acquisition of inventory, or what accountants refer to as the “cost of goods sold.” These taxpayers may not be permitted to claim deductions for expenses that are “ordinary and necessary” to carry on a particular trade or business, including wages paid to employees, rent of facilities or equipment, interest, marketing or utility expense. As a result, federal income taxes are assessed against these taxpayers on a modified gross receipts basis irrespective of profitability. These taxpayers can face substantial tax liabilities even in years when they operate at a financial loss. Whitney Economics, a market analytics firm, has estimated that state-licensed marijuana businesses in the United States paid \$1.8 billion in excess taxes in 2022 alone due to the lack of deductibility of expenses.² Only an estimated one-fourth of state-licensed marijuana businesses were profitable in that year. If state-licensed marijuana businesses were freed of the constraints of Sec. 280E, they would collectively retain billions of dollars in extra capital with which to make investments, innovate with new products, and create new employment opportunities in the states in which they operate.

Similarly, the PATRIOT Act and other federal anti-money laundering laws require financial institutions chartered in the United States to implement enhanced surveillance techniques over account holders they believe may be involved in the sale, manufacture, or distribution of any substance listed under Schedules I or II of the CSA. The Financial Crimes Enforcement Network (FinCEN) promulgated rules in 2014 with the ostensible purpose of facilitating financial services for state-licensed marijuana businesses in good standing due to the public safety risks inherent in forcing businesses to operate predominantly in cash and to hold or transport large amounts of cash. FinCEN’s rules, however, require financial institutions to regularly and thoroughly review and report on the transactions made by state-licensed marijuana companies to ensure they are compliant with state laws and do not implicate possible illicit diversion of marijuana inventory. These procedures are labor-intensive and costly for financial institutions. Further, financial institutions that do not rigorously comply with these requirements face substantial civil or even criminal liability.³

As a result, most financial institutions have voluntarily decided not to offer accounts to persons or businesses involved in the state-licensed marijuana industry. In some cases, even law firms, accounting firms, and media outlets that transact with these businesses, but which have no direct involvement in the marijuana industry, have been denied financial services. Employees of marijuana businesses are regularly denied home mortgages because their income is derived from a federally illegal source. The lack of financial services available to state-licensed marijuana industries negatively affects bank liquidity and the M2 money supply by making money held as cash unavailable to be lent to other borrowers in need of capital. Marijuana businesses also face steep transaction costs for dealing with cash, which negatively affects their profitability and returns to shareholders. Employees who are unable to qualify for a mortgage are hindered from building home equity, and excluding them from the housing market artificially suppresses housing demand.

² Whitney Economics, “2022 U.S. Cannabis Supply Report,” [report], May 2023, <https://whitneyeconomics.com/report/2022-whitney-economics-us-cannabis-supply-report>

³ Geoffrey Lawrence, “Marijuana Industry Financial Services: Obstacles and Policy Solutions,” Reason Foundation policy brief, September 2019, <https://reason.org/wp-content/uploads/marijuana-industry-financial-services.pdf>.

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Criminality Imposes Steep Economic Costs

Significant government expenditures are required to enforce state and federal laws that prohibit marijuana. These expenditures include the costs of policing for infractions, incarcerating offenders, and overseeing the subsequent parole or probation of these offenders. Harvard University economist Jeffrey Miron estimated in 2018 that state and local governments were spending \$6 billion annually on these expenses while the federal government spent an additional \$4 billion.⁴

In addition to these direct expenses, society is deprived of productive labor that could be offered by individuals who are arrested for a marijuana offense. While these individuals are incarcerated, they cannot contribute productively to their local economy, and their lifelong personal financial growth is stunted by the collateral consequences of carrying a criminal conviction. The American Bar Association noted in 2018 that nearly 9 in 10 employers conduct background checks prior to hiring and that “approximately 60% of formerly incarcerated individuals remain unemployed one year after their release.”⁵ When formerly incarcerated men do find jobs, they take home 40% less annual pay. Women are similarly affected. Indeed, the loss of gross domestic product “due to employment barriers for people with criminal records was as much as \$65 billion annually.”⁶ While these figures apply to all incarcerated persons and not just marijuana offenders specifically, the lost productivity of individuals arrested on marijuana charges are clearly substantial.

These costs would be ameliorated if the DEA elects to move marijuana from Schedule I to Schedule III, but significant costs would still remain. Under Schedule III, only individuals with a valid prescription would be legally able to possess marijuana and marijuana could only be legally produced by properly licensed businesses following FDA protocols. All existing state-licensed marijuana activity, regardless of whether that activity is labeled “medical” or “adult-use,” falls short of these standards and would therefore remain federally criminal. Although physicians may recommend the use of marijuana to their patients in many states, with no FDA-approved marijuana products, doctors would not be able to prescribe marijuana, even for “off-label” use. Consequently, patients would not be able to legally source physician-recommended marijuana medicines. As discussed below, it cannot be assumed that physicians would gain the power to prescribe marijuana as a result of moving the substance to Schedule III. In nearly all cases, the costs of federal criminality on both individuals and society at large would remain even subsequent to the DEA’s decision to move marijuana to Schedule III.

Capital Formation and Entrepreneurship

Entrepreneurial opportunities within state-licensed marijuana industries are limited by an individual’s access to the capital needed to start a business. Federal criminality of marijuana severely limits the potential sources of this capital. Any capital contributor to a state-licensed marijuana company could be construed as a material participant or as aiding and abetting a federal criminal enterprise. As a result, institutional lenders such as banks, which are traditional capital sources for many startup enterprises, refuse to lend to state-licensed marijuana businesses. Such banking restrictions have also significantly reduced federal tax receipts. According to the Treasury Inspector General for Tax Administration, the lack of banking services resulted in \$48.5 million in unassessed taxes from the infant marijuana industry in fiscal year 2016, which Reason Foundation estimates equals hundreds of millions of dollars lost in the current market.⁷ Major stock exchanges in the United States also refuse to list securities issued by state-

⁴ Jeffrey Miron, “The Budgetary Effects of Ending Drug Prohibition,” Cato Institute Tax & Budget Bulletin, July 23, 2018 (Number 83), <https://www.cato.org/sites/cato.org/files/pubs/pdf/tbb-83.pdf>.

⁵ American Bar Association, “Collateral Consequences of Criminal Convictions: Judicial Bench Book,” March 2018, <https://www.ojp.gov/pdffiles1/nij/grants/251583.pdf>.

⁶ Ibid.

⁷ Jacob James Rich, “How Congress’ Proposed Marijuana Banking Reform Would Boost Government Budgets,” Reason

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licensed marijuana businesses, limiting the growth potential of marijuana businesses even after they have successfully demonstrated a market for their products.

As a result, entrepreneurship in this industry is frequently limited to individuals who already possess significant financial assets. Other entrepreneurs may be forced to accept high-interest loans due to the high-risk premium that the relatively narrow market of remaining available lenders demand. In many cases, entrepreneurs may lose control of the business due to loan provisions that allow the debt holder to convert debt to equity if the business is successful.⁸

Prescriptions, Drug Approval, and FDA Regulation

Perhaps the most notable economic effect of moving marijuana from Schedule I to Schedule III will be the impact of regulation by the U.S. Food and Drug Administration (FDA). As the Congressional Research Service has pointed out, Schedule III drugs may be legally dispensed only by prescription, and prescription drugs must be approved the FDA.⁹ In fact, any substance that a manufacturer claims to be useful in the treatment of any disease is legally considered a drug and must be approved by the FDA before the manufacturer can market that substance.¹⁰ Although the FDA has approved one synthetic cannabinoid (dronabinol) and one isolated natural cannabinoid (cannabidiol) as pharmaceuticals available by prescription, marijuana is not an approved drug.

Although the FDA has generally deferred to DEA enforcement for substances listed under Schedule I, a Schedule III designation may prompt the FDA to take enforcement action against state-licensed marijuana companies marketing marijuana as an unapproved drug. FDA enforcement could include destruction of inventory and issuance of cease-and-desist orders. These actions would be financially catastrophic to existing state-licensed marijuana companies.

Moreover, the FDA's existing drug approval pathway is ill-suited for evaluating the effectiveness of marijuana in treating any disease because drug trials are generally designed to evaluate a single active molecule. Marijuana contains more than 100 naturally occurring cannabinoids along with hundreds of terpenoids and flavonoids.¹¹ These molecules may be present in varying concentrations depending on the particular cultivar of marijuana, growing conditions, and a host of other factors. The capitalized cost of successfully bringing a new drug to market in the United States during the period 2009–2018 has been estimated at \$1.3 billion and often takes more than a decade to complete.¹² Drugs that combine multiple active molecules typically must evaluate each molecule individually and then evaluate the combination. Even if approval were assured, the cost a drug sponsor would incur to bring raw marijuana flower or full-spectrum extracts to market would be prohibitive in terms of both time and money. No existing marijuana company with publicly available financial information has sufficient liquid assets to bring marijuana to market as an approved drug.

Foundation commentary, August 2020, <https://reason.org/commentary/how-congress-proposed-marijuana-banking-reform-would-boost-government-budgets/>

⁸ Geoffrey Lawrence, "Marijuana's Social Equity Misfire: Why State Efforts to Promote Restorative Justice Within the Cannabis Industry Have Failed, and How a Market-Based Approach Can Provide Better Outcomes," Reason Foundation policy brief, April 2023, <https://reason.org/wp-content/uploads/marijuana-social-equity-misfire.pdf>.

⁹ Joanna R. Lampe, "Legal Consequences of Rescheduling Marijuana," Congressional Research Service Legal Sidebar 11105 (Version 2), May 1, 2024, <https://crsreports.congress.gov/product/pdf/LSB/LSB11105>.

¹⁰ Geoffrey Lawrence, "How to Reform the FDA," Reason Foundation policy brief, August 2022, <https://reason.org/wp-content/uploads/focus-at-the-fda.pdf>.

¹¹ Erin M. Rock and Linda A. Parker, "Constituents of Cannabis Sativa," *Advances in Experimental Medicine and Biology*, 2021, 1264: 1-13. Available at: <https://pubmed.ncbi.nlm.nih.gov/33332000/>.

¹² Lawrence, note 8.

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Although the FDA’s drug approval process is intended to protect the public from potentially dangerous or ineffective drugs, the barriers implied by this process make it unlikely that marijuana can be successfully marketed as a prescription drug. As a result, participants in existing state-licensed marijuana marketplaces are likely to continue operating afoul of federal law even if marijuana is moved from Schedule I to Schedule III. Indeed, the only pathway for making all of the medical applications of marijuana legally available to the public would be through fully descheduling the substance.

Conclusion

We believe that a Schedule III designation would result in tax relief that would allow state-licensed marijuana businesses to invest, expand, and offer greater employment opportunities. These businesses, along with their employees and ancillary contractors, could gain expanded access to basic financial services.

Despite these benefits, a Schedule III designation fails to fully align federal and state law in the states that authorize some form of commercial market in marijuana. As a result, both consumers and producers would remain subject to an array of criminal penalties. Enforcement of the federal approach would consume taxpayer resources, strip individuals convicted of marijuana offenses of their freedom, and deprive society of the prospective economic contributions of these individuals. All existing state-licensed marijuana activity would remain criminal under a Schedule III designation, and so significant barriers to entrepreneurship would remain. Finally, it is unlikely that marijuana could ever secure approval to be marketed as a prescription drug under the FDA’s existing drug approval pathway. Unless the FDA defers its enforcement powers or develops a new pathway to approve marijuana and products containing marijuana extracts, a Schedule III designation may pose an existential financial risk for existing state-licensed marijuana businesses.

For these reasons, we believe that a Schedule III designation is still overly restrictive for marijuana. The cannabis sativa plant from which marijuana comes is deeply intertwined with the American founding. The original Jamestown charter required every property owner to cultivate cannabis for export to England, and much early American commerce was centered around the cultivation and processing of this plant for sailcloth and cordage. George Washington and Thomas Jefferson cultivated cannabis, while Benjamin Franklin owned a cannabis processing facility. Betsy Ross stitched the first American flag out of cannabis fabric.¹³ One might say that cannabis is even more American than apple pie. We applaud the effort of the DEA to move marijuana from Schedule I to Schedule III, but humbly request that the DEA further consider removing cannabis entirely from scheduling under the CSA.

¹³ Geoffrey Lawrence, “A Historical Review of State Efforts to Regulate Cannabis,” Reason Foundation policy brief, April 2019, <https://reason.org/wp-content/uploads/cannabis-and-states-power-historical-review-of-regulation.pdf>.

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