

Federal Cannabis Prohibition Got a Lot Weaker in 2018



Prohibition has inertia but no momentum.

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Any listing of cannabis legalization highlights for 2018 has to begin with the triumph of marijuana at the ballot box in the midterm elections – voter approval for adult use in Michigan and medical marijuana in states as culturally conservative as Utah and Missouri, the defeat of virulently anti-cannabis Rep. Pete Sessions of Texas and the election of pro-legalization governors and state legislators. The big shifts in cannabis in 2018 were at the state level. Progress toward the ultimate goal – federal legalization – was subtle but significant nonetheless.

The dizzying pace of the news makes it easy to forget 2018

began with then-Attorney General Jeff Sessions reversing the hands-off Obama era policy toward state-legal cannabis businesses. The decades old ban on hemp was lifted, giving America's farmers a lucrative new crop and creating a large and legal (though regulated) source of CBD. A disappointment in tax court reminded the cannabis industry that prohibition is deeply embedded in federal law, but a close look at 2018 shows political support for federal prohibition is weakening.

Jeff Sessions' crackdown revealed prohibition has no constituency.

Presuming you have not already forgotten Jeff Sessions entirely, do you remember the angst that seized the cannabis industry in 2017 when he was appointed Attorney General? There was immense worry Sessions, an anti-marijuana zealot, would rescind the Cole Memo, which then was believed to be the single thread keeping the Department of Justice from smashing the legal marijuana businesses taking root in states from California to Massachusetts.

It took him a full year to do it but Sessions rescinded the Cole Memo as practically his first official act of 2018. The crackdown, however, never followed. Senator Cory Gardner, an otherwise conservative Republican from Colorado, thought Sessions had promised during his nomination not to enforce federal marijuana laws in states – such as Colorado – that had legalized. Feeling betrayed, Gardner used his senatorial prerogative to block dozens of top appointments to the Department of Justice, vowing he would not relent until the hands-off policy was reinstated. Trump eventually sided with Gardner and Sessions let the matter drop.

Sessions, who drew no distinction between medical and adult use marijuana, wanted a free hand to shut down medical dispensaries. Beginning in 2014 Congress has annually added a rider to the budget of the Department of Justice forbidding it

from spending a penny harassing medical marijuana dispensaries or patients. When Sessions demanded Congress drop the restriction, Congress responded by ignoring him. The rider remains in place.

By trying and failing to reverse Obama era policies on state-legal marijuana, Sessions ended up making them permanent.

Related: AG Jeff Sessions Was (Basically) Fired: The Cannabis Industry Reacts

Hemp, which never should have been illegal, is now legal.

The sprawling Farm Bill of 2018 includes the Hemp Farming Act that ends decades of prohibition on growing an ancient and extraordinarily useful crop. The bill removes hemp containing no more than 0.3 percent THC from the Controlled Substances Act, largely frees the crop from federal regulation except by the Department of Agriculture and generally makes hemp a normal crop eligible for crop insurance and available for research.

The implications are difficult to exaggerate. Farmers who have struggled with years of depressed commodity prices made worse by Trump's trade war with China are talking about a hemp "gold rush" in a market expected to grow from \$820 million in 2017 to at least \$10.6 billion in 2025, according to Grand View Research. While CBD is the most prominent current use for hemp, it is far from the only market. The FDA has cleared hemp seeds as a food ingredient. Hemp fiber and byproducts have literally thousands of uses, including as paper, cotton substitutes and plastics, though realizing that potential will first require building processing facilities.

Related: CBD Is Just the First Huge Benefit From Legal Hemp

FDA is winning a turf war with DEA over who will regulate CBD.

In June, the Food and Drug Administration made history by approving Epidolex, the first drug ever approved with an ingredient – CBD – derived from cannabis. That approval put the DEA, which insists on keeping all forms of cannabis on Schedule 1 as a drug with no medical use, in a corner. Left with no real option, the DEA removed FDA approved drugs containing CBD from Schedule 1 – the first time the agency has backed off on prohibition to the least degree.

The FDA approval of Epidolex comes as the global medical establishment is reexamining the assumption that cannabis has no medical use. The FDA has argued that CBD should be removed from Schedule 1 but the DEA contends America's obligations under two global narcotics treaties requires cannabis in all forms be prohibited, which is why the agency agreeing to reschedule FDA approved drugs with cannabis ingredients is so significant.

The tussling over regulatory turf escalated with the Farm Bill legalizing hemp. FDA Commissioner Scott Gottlieb, in a lengthy statement issued after President Trump signed the Farm Bill, made clear that legally sourced CBD is still a regulated substance and the agency will oversee its use in foods, nutritional supplements and prescription drugs. While that is likely to slow the rush to infuse everything that can be eaten or drunk with CBD, it means CBD will be regulated by a science-based agency instead of being banned from use by federal narcotics agents.

Related: The DEA Actually Didn't Reschedule CBD: Industry Insiders Explain What Epidiolex's Reclassification Really Means

Prohibition fervor still burns hot at the IRS.

What's the difference between a guy selling drugs from his apartment in 1974 and a licensed marijuana dispensary in squeaky-clean compliance with every applicable state and local law and regulation today?

The drug dealer in 1974 was allowed to deduct business expenses. The dispensary operating legally today largely is not.

"You take any other business operating and cannabis is paying a much higher effective tax rate," says Dana Borys, tax partner and tax segment leader at MGO, a professional services firm with a significant cannabis practice. "They're still making money but somebody opening a new business is very surprised to see how much they are paying in taxes. They are learning, often a little late, they can't deduct a lot of expenses they could ordinarily.'"

Just after Thanksgiving the US Tax Court handed down a ruling that Harborside Health Center of Oakland, Calif., one of the longest operating and best regarded dispensaries in the nation, could not take ordinary business expenses for tax years 2007 to 2012. Harborside now owes many millions in federal taxes. The ruling, like all things tax related, is a tough read if you're not an accountant but Judge Mark Holmes made the main point clear: Harborside "may well be the largest marijuana dispensary in America," the judge wrote. "To the Commissioner (of the IRS) that just makes it a giant drug trafficker, unentitled to the usual deductions that legitimate businesses can claim."

Judge Holmes ruled Harborside, and every other legal marijuana dispensary, remains a drug dealer to the IRS for one simple but inflexible reason: section 280E of the Internal Revenue

Code, which was added in 1982 after a drug dealer cornered into filing a tax return successfully fought to deduct his mileage, phone bill and other routine expenses of running a business (even an illegal business). The ban on deducting business expenses for drug dealing was all but forgotten until California voters legalized medical marijuana in California in 1996, said Harborside's attorney, Henry J. Wykowski.

"It's clear from (the judge's) opinion that this is a confusing area for the taxpayer and the IRS has issued no guidance," Wykowski said. "The judge concedes that someone else could see it differently."

Harborside brought its case in hopes of a favorable decision that would effectively invalidate 280E for state-legal cannabis businesses. Harborside is likely to continue fighting in the appeals courts, but Wykowski said the real solution is for Congress to change the law.

"What we tried to do was change the law and we didn't succeed, yet," Wykowski said. "I hope in my heart of hearts that this will all become irrelevant when the STATES Act passes."

His hope isn't farfetched. Remember the deal Senator Gardner reached with President Trump? In return for Gardner getting out of the way of appointments to top jobs at the Department of Justice, Trump agreed, at least in principle, to support a new law to permanently bar the federal government from interfering with cannabis businesses that comply with state law. With that agreement, Gardner and Senator Elizabeth Warren, D-Mass, introduced the STATES Act, which among other things specifies that profits from legal marijuana businesses would no longer be deemed the proceeds of a crime, which would allow the industry to use banks and, presumably, normal tax deductions.

Prohibition definitely began to show cracks in 2018. It may not be long before it collapses.

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