

Will Congress's Marijuana Tax Die an Administrative Death?

by Patrick Oglesby

Reprinted from *Tax Notes Federal*, September 16, 2024, p. 2277

Will Congress's Marijuana Tax Die an Administrative Death?

by Patrick Oglesby

Patrick Oglesby is a lawyer in North Carolina and founder of the nonprofit Center for New Revenue. He thanks Jon Caulkins, Dale Gieringer, Keith Humphreys, Beau Kilmer, Rob Mikos, and Justin Strelak for comments on an early draft of this article.

In this article, Oglesby examines the effects of section 280E on the ability of cannabis businesses to deduct expenses and explains the tax implications of a possible reclassification of marijuana from Schedule I of the Controlled Substances Act to Schedule II or III.

Copyright 2024 Patrick Oglesby.
All rights reserved.

The Federal Marijuana Tax

Today's sellers of marijuana can deduct only the cost of goods sold on federal income tax returns — thanks to section 280E, an obscure drug war law from 1982.¹ However, bypassing Congress, the Biden administration may let marijuana sellers deduct selling expenses as other businesses do.

Section 280E provides that:

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by

¹More precisely, taxpayers use COGS as an adjustment to gross income rather than a deduction. Meanwhile, many states maintain rolling conformity, that is, automatic adoption of federal income tax provisions. Several states have stopped conforming to section 280E. Owen Racer and Angélica Serrano-Román, "Pot-Friendly States Give Cannabis Sellers Tax Help Denied by IRS," *Bloomberg Daily Tax Report*, Aug. 1, 2024.

Federal law or the law of any State in which such trade or business is conducted.

The Biden administration is formally considering rescheduling marijuana — moving it from Schedule I of the Controlled Substances Act to Schedule III.² Under Schedule III, the section 280E selling expense tax³ would no longer apply to marijuana sellers.⁴ A move to Schedule II would leave the section 280E tax intact. There are nontax differences between schedules II and III that are not at issue here, but "the biggest impact of rescheduling [to III], by far, is taxes."⁵

A Dilemma

On the one hand, section 280E protects public health — pushing against the noise of marijuana commerce, the search for new and inexperienced customers, and marijuana's kid appeal. And it provides federal revenue.

On the other hand, eliminating section 280E would remove a tax disadvantage for taxpayers in the state-legal marijuana industry. Their direct competitors — state-legal hemp drug THC

²See Department of Justice release on proposed regulation to reschedule marijuana (May 16, 2024). For an excellent explanation of rescheduling, see Robert A. Mikos, "The False Promise of Rescheduling," *Vanderbilt Law Research Paper No. 24-21* (May 1, 2024).

³Section 280E is known as a "selling expense tax." Calling the denial of deductions a tax is shorthand. People also refer to the limitation on depreciation deductions for high-end vehicles in section 280G as a luxury car tax. For a longer though primitive look at section 280E, see Pat Oglesby, "How Bob Dole Got America Addicted To Marijuana Taxes," *Brookings FixGov* (Dec. 18, 2015); Jonathan P. Caulkins et al., "Considering Marijuana Legalization: Insights for Vermont and Other Jurisdictions," *RAND Corp. Research Report Appendix B* (Jan. 16, 2015).

⁴Marijuana here means cannabis subject to Schedule I. Whatever happens with marijuana, section 280E would still apply to other Schedule I drugs like heroin and LSD, whose sellers, unlike marijuana sellers, don't publicly complain about section 280E.

⁵Kobie Evans, quoted in Esha Walia and Diti Kohli, "Cannabis Businesses Can Pay Up to 80 Percent in Taxes. Could Easing Federal Restrictions Provide Relief?" *The Boston Globe*, May 28, 2024. To simplify, Schedule I is designed for the most dangerous drugs and restricts their use severely; Schedule II drugs are deemed less dangerous and face fewer restrictions; Schedule III is a further step down from Schedule II.

merchants who sell psychoactive-equivalent drugs legalized by the Agriculture Improvement Act of 2018 (Farm Bill) — owe only regular income tax and have no special section 280E federal tax burden. Despite section 280E's advancement of public health goals and its ability to bring in federal revenue, that competitive disadvantage is nonsensical.

Some of Section 280E's Effects

Today, the deduction denial for drug dealers in section 280E means that sellers of marijuana (still listed in Schedule I) may deduct only COGS — what they spend to make or buy marijuana.⁶ That is, sellers can't deduct selling expenses — everything other than COGS.

Consumers don't pay or notice the (nonsalient to them) section 280E selling expense tax, which affects industry players in different ways. Marijuana growers typically don't pay much selling expense tax. They deduct the bulk of their expenses, such as clones, seeds, irrigation, fertilizer, salaries of horticultural employees who produce marijuana under the make-or-buy rule, and most rent and utilities. Retailers, meanwhile, can't deduct huge selling expenses such as sales commissions, salaries of employees interfacing with customers, rent, utilities, and tobacco-style "power wall" retail displays. Distributors also incur meaningful selling expenses. For processors, the section 280E burden will vary depending on how intensively they market their products. Their costs to buy raw plant material and to process it are fully deductible, but any promotional or branding expenses and the like are not.

Sellers throughout the supply chain arrange to deduct state excise taxes as part of COGS,⁷ but none may deduct the cost of billboards, display signs, internet ads, or celebrity endorsements. Only marijuana sellers pay the section 280E tax, but they don't bear it all economically.

⁶ Committee and general explanation language protects COGS — technically, retaining COGS as an adjustment to gross income rather than saying it is deductible. S. Rep. No. 97-494, at 309 (volume 1); or Joint Committee on Taxation, "General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982," JCS-38-82, at 264 (Dec. 31, 1982). Product testing and improvements count as COGS, so they remain deductible.

⁷ ILM 201531016.

Suppliers of ancillary services like advertisers and retail landlords receive nondeductible payments, so those service providers take an indirect hit from section 280E because the tax incidence or economic burden of section 280E does not land entirely on marijuana sellers. Some of the burden lands on consumers, too. And, as discussed below, section 280E is overbroad.

The History

Critics of the section 280E selling expense tax say that it was conceived as a weapon in the (to them) discredited war on drugs.⁸ The selling expense tax came into law in 1982, when Republicans controlled both the Senate and White House and Sen. William L. Armstrong, R-Colo., a marijuana prohibitionist, learned of a Tax Court case in which the IRS contested miscellaneous business expenses (like meals and entertainment) of a dealer in Schedule I and II drugs — amphetamines, cocaine, and marijuana.⁹

Looking for an opportunity to prosecute the war on drugs, Armstrong introduced a bill to stop the deduction of those selling expenses and got Senate Finance Committee Chair Bob Dole of Kansas to put it into his chairman's¹⁰ mark for the Senate version of the 1982 tax bill.¹¹ That tax bill, the Tax Equity and Fiscal Responsibility Act, contained scores of disjointed revenue raisers, among them the section 280E selling expense tax,

⁸ Nick Richards, "280E Is a Political Weapon Targeting Marijuana Companies, but There May Be a Fix," *MJBizDaily*, Apr. 14, 2021.

⁹ *Edmondson v. Commissioner*, T.C. Memo. 1981-623 ("Commissioner disallowed all of petitioner's miscellaneous business expenses and his vehicle expense."). The case seemed about only substantiation and amount; the court didn't address illegality, under a long-standing tax doctrine ignoring criminality of income-producing activities. "For example, if M opens a business that offers to kill people for a fee, . . . the cost of bullets and poison are legal expenses and can be deducted by M." Douglas A. Kahn and Howard Bromberg, "Provisions Denying a Deduction for Illegal Expenses and Expenses of an Illegal Business Should Be Repealed," 18 *Fla. Tax Rev.* 207, 222 (2016). The section 280E selling expense tax applies to sales of drugs like heroin and LSD, too, but those sales are less visible and harder to tax than state-legal marijuana sales.

¹⁰ Staffers said "chairman's mark" rather than "chair's mark" back then to refer to working documents in front of the taxwriting committees. I was on the staff of the Joint Committee on Taxation when section 280E was enacted, though I didn't work on it or pay memorable attention to it.

¹¹ Oglesby, "Origin of Section 280E," Center for New Revenue (Nov. 19, 2017). We may wonder why Dole accepted Armstrong's proposal. Because he liked the policy? To do Armstrong a favor? Because he was assembling an anti-Christmas-tree bill (call it a lumps-of-coal bill) of revenue raisers? Because the drug war was in full swing and few wanted to speak up against harshness for drug sellers?

which sailed through Congress with no member-level opposition detected.¹²

In 1982, when section 280E was enacted, it largely burdened only traffickers violating state law. Who knows what the authors of section 280E would have thought about its eventual tax burden on state-legal businesses operating openly under federal illegality and forbearance? While “loophole” is an accepted term for an unintended legal benefit, there seems to be no handy phrase for an unintended legal burden. The section 280E selling expense tax on state-legal businesses may be an unintended legal burden. Its current burden was hardly foreseeable.

No Federal Marijuana Tax?

Marijuana’s transfer to Schedule III would end section 280E’s tax burden on sellers and leave the federal tax burden on marijuana commerce equal to the burden on commerce in, say, tomatoes or cotton. This would be far less than the tax burden on alcohol or tobacco that is subject to federal sumptuary excise taxes, so-called sin taxes.

Should there be some special extra federal tax on marijuana? It will presumably cost money to regulate, and it allegedly creates net negative externalities. While medical marijuana is hard to distinguish from recreational marijuana, its externalities should be positive. And maybe, as some enthusiasts suggest, even recreational marijuana use, in the aggregate, is so net beneficial that society should promote it — or not push against it. But negative externalities, like youth use, cannabis use disorder, and stoned driving need to be accounted for.

For now, all congressional proposals for legalizing marijuana would repeal section 280E and replace it with some other tax. Congress, though, shows no signs of enacting or even advancing those proposals. Still, it’s hard to imagine Congress passing a stand-alone repeal of section 280E without a revenue offset, which is the

result that putting marijuana on Schedule III would produce. Given that there isn’t a congressional majority for a marijuana tax cut today, the tax cut created by rescheduling marijuana would defy actual congressional intent or at least sentiment.

Unofficial revenue estimates say the state-legal marijuana industry generated \$1.8 billion in section 280E federal taxes in 2022 and that for fiscal 2023 that figure may rise to \$2.1 billion.¹³ That’s a drop in the federal bucket. Anyway, taxes and making ends meet are out of favor in America today. Luckily for us elderly taxpayers, the government just borrows the money it wants for now.

Tax Policy Background

The section 280E selling expense tax conflicts with (1) standard general tax rules based on the goal of taxing all income alike, a goal that the folks I admire most in tax policy recommend, and (2) specific targeted rules that encourage payments like employee health benefits, which are not income to the recipient but are now nondeductible to the payer under section 280E.

The standard tax approach to “temptation goods” is to match the tax burden to the cost of the externalities of the goods and regulatory costs involved with the industry. The section 280E burden is unrelated to those costs.

Imposing a tax burden on a product that is federally illegal — even if winked at — is a stretch for a coherent theory of taxation and government.¹⁴ The section 280E burden may look like a penalty disguised as a tax, although other disfavored activities bear extra income tax burdens, such as the section 280G burden on golden parachutes and the section 162(e) denial of deductions for lobbying expenses. The punitive appearance of section 280E may even engender resentment and retaliatory tax evasion — by an industry that openly violates nontax federal laws.¹⁵

¹² Though surely staff, who understood that the tax law would leave an assassin’s bullets deductible, must have wondered about hitting drug dealers harder than murderers. Whatever one thinks of the Senate Finance Committee’s report that said COGS must remain deductible, deductibility is the right result. Had COGS not been deductible, cascading taxes would have encouraged or practically mandated consolidation and vertical integration, which is not an outcome policy should favor. Washington state’s abandonment of its early cascading marijuana excise taxes proves the point.

¹³ Solomon Israel, “What the End of 280E Might Mean for Cannabis Business Taxes,” *MJBizDaily*, Oct. 17, 2023.

¹⁴ Many states tax illegal substances, at least nominally. Hayes Holderness, “Crack Taxes and the Dangers of Insidious Regulatory Taxes,” 95 *South. Cal. L. Rev.* 483 (2022).

¹⁵ Lisa N. Sacco, Joanna R. Lampe, and Hassan Z. Sheikh, “The Federal Status of Marijuana and the Policy Gap With States,” Congressional Research Service IF12270 (updated May 2, 2024).

In any event, section 280E is discriminatory. No commerce other than drug commerce is subject to this selling expense tax penalty. Income from other illegal activities — prostitution, cigarette smuggling, gun running, and murder for hire — is not touched by the special section 280E nondeductibility rule. So the gun smuggler can deduct business meals and entertainment expenses¹⁶ but the marijuana retailer can't.

Are progressive taxes a good idea? That is, should tax rates increase as income rises? I'll say yes, but that's an ideological question. The section 280E selling expense tax is a feature of the progressive federal income tax.¹⁷ Excise taxes imposed on products like tobacco and alcohol are typically more regressive than section 280E's quasi surtax on income.¹⁸

A Tax on Marketing

If we are to have marijuana taxes, what might they target? That is, what should their tax base be?

Section 280E targets selling expenses. If marijuana is to be taxed, section 280E is excellent.¹⁹ Some selling expenses tend to promote use by kids. Some tend to promote problematic consumption. Some look like frills. So, selling expenses may be optimal or at least acceptable targets to tax — compared with the alternatives.

Kids pay attention to marijuana advertising and glitzy marketing,²⁰ at least out of the corners of their curious eyes, despite regulations and restrictions. That puts them at risk — and irritates parents, who then oppose legalization efforts, which most citizens supposedly support, although the Biden administration has not enthusiastically joined legalization efforts beyond its proposal to reschedule marijuana.

"Marijuana sells itself," the saying goes. But many selling expenses seek to goose demand. Cannabis use disorder sufferers and potential sufferers don't need their demand stoked, so stoking demand among consumers who suffer from or risk suffering from that condition is problematic. Historically, marijuana commerce operated by word of mouth — underground. Traditional growers did the opposite of advertising. They learned how to hide. Consumers did not need advertising to find what they wanted. Harm-reduction reformers, whose goals start with stopping arrests, are not leading the charge for advertising rights and marketing efforts. So the anti-ad, anti-marketing bias for section 280E rules might help mollify skeptics of legalization — without bothering supporters too much. Some people in state-legal markets oppose state constitutionally protected public-view marijuana advertising. Meanwhile, to many supporters of legalization, marketing is a frill, and a tax break for advertising was never a goal.

But let's be clear, section 280E is overbroad. It hits not just selling expenses that are deleterious or frills but also more sympathetic selling expenses, like low-paid retail clerks' salaries and benefits. In any event, section 280E penalizes even advertising that doesn't persuade, entice, or stoke demand. Ads listing hours of operation, for instance, inform rather than persuade.²¹

Some people generally oppose taxes like section 280E that may influence behavior. Indeed, sometimes taxes that seek to influence behavior backfire and create important unintended consequences — so the hoped-for cure is worse than the disease.

Taxation Versus Regulation

Regulation, if available, could achieve public health goals more precisely than the blunt

¹⁶ Subject now to a statutory 50 percent cap.

¹⁷ Some taxpayers incur such severe economic losses that they remain in an income tax loss position even after section 280E. Loss carryforwards are their only hope.

¹⁸ Some excise taxes are not regressive, like those on jewelry or fuel for private jets.

¹⁹ Consumer lobby "NORML supports regulatory controls that seek to limit youth exposure to adult-use cannabis-related advertising and marketing as well as efforts to not incentivize advertising cannabis products through the tax code." National Organization for Reform of Marijuana Laws, "Core Attributes of Adult Access Regulations," NORML Fact Sheet (last accessed Jul. 28, 2024).

²⁰ Elizabeth D'Amico, "Why Children Need to Be Shielded From Marijuana Ads," Rand Corp. (Jun. 18, 2018).

²¹ Section 280E may encourage weird workarounds like retailers having cashiers slowly roll joints when idle. That joint-rolling part of their work is production, not selling, so some of their hourly pay arguably goes into deductible COGS rather than into nondeductible selling costs. And section 280E is much easier to administer in jurisdictions that force marijuana commerce to stand apart from other commerce in dedicated marijuana stores. Extending section 280E to hemp drugs would be especially hard to administer so long as hemp drugs continue to be sold in convenience stores, gas stations, bars, and restaurants.

instrument of section 280E, and arguably more than any tax scheme.

But advertising and marketing bans and even restrictions usually don't withstand federal (or state-analog) First Amendment scrutiny. Congress cannot readily, under recent constitutional doctrines, ban or do much nontax legislating about stand-alone commercial speech, but I'm unaware of free speech challenges to section 280E.

Broadly, income tax deductions depend on legislative grace — the legislative branch can grant them or deny them. If the First Amendment protected tax deductions, lobbying expenses would be deductible, but section 162(e) says they aren't.

Lots of citizens are fed up with demand-stoking advertising generally — not just advertising for temptation goods.²² And I'll take the view that there should be no constitutional right to a tax deduction.²³ The founders put taxwriting as close to the people as they could, with special favor for the House of Representatives.²⁴

Meanwhile, there have been suggestions to extend section 280E to the alcohol and tobacco industries — and to deny deductions for direct-to-consumer pharmaceutical ads.²⁵ But those

suggestions depend on an unlikely congressional defiance of powerful industries.

Other Federal Marijuana Tax Options

If there is to be a federal marijuana tax, eliminating the section 280E selling expense tax may be premature. Other marijuana taxes are being tried in various jurisdictions and found wanting.²⁶

Standard excise taxes require novel administrative regimes if not bureaucracies. Taxing by weight of raw plant material presents administrative and conceptual difficulties; so does taxing by weight of THC.²⁷ Taxing by percentage of price (ad valorem) can be gamed (free pot with pipe), flimsy (employee and quantity discounts), and vulnerable to predictable price declines. The federal government uses ad valorem excise taxes on the sale of goods very rarely — apparently only as an alternative to a per-unit rate for large cigars.²⁸ An ad valorem retail federal excise tax on the sale of goods would be a new and fresh idea.

Section 280E may look good by comparison.

Small Business, Big Business

While small-business promotion is at most a second-order goal for tax policy, federal tax policy sometimes seeks to promote small business over big business, like with lower excise tax rates for craft brewers and wineries. But sometimes it doesn't, as shown by the repeal of graduated corporate income tax rates in 2017.

In any event, small business relies more on free word of mouth than big business does. Big business spends money to advertise and promote sales more than small business. Those expenses are now nondeductible, but Schedule III would make them deductible. With relatively less capital, mom-and-pop outfits, social equity

²²Nicole Torres, "Advertising Makes Us Unhappy," *Harv. Bus. Rev.* (Feb. 2020). Digital advertising taxes have gained prominence and some acceptance in recent years. Daron Acemoglu and Simon Johnson, "The Urgent Need to Tax Digital Advertising," *Network L. Rev.* (Mar. 25, 2024). In 2014 Republican Ways and Means Chair Dave Camp proposed that even standard advertising should not be deductible upfront — some costs should be amortized, or spread out over time. PwC, "Overview of Ways and Means Chairman Camp's Tax Reform Discussion Draft," Tax Insights From Washington National Tax Services (Feb. 28, 2014). That approach might at least better match deductions with income over the years.

²³But consider the thoughtful analysis in Leslie Gielow Jacobs, "Regulating Marijuana Advertising and Marketing to Promote Public Health: Navigating the Constitutional Minefield," 21 *Lewis & Clark L. Rev.* 1081, II.B.5 (July 27, 2017). Maybe a tax more targeted at speech than section 280E could let the justices seize the taxing power, but for now, at least, section 280E avoids various constitutional problems. See, e.g., *Alpenglow Botanicals LLC v. United States*, 894 F.3d 1187 (10th Cir. 2018).

²⁴Now the courts are busy seizing power generally, for instance by downplaying administrative expertise with the demise of *Chevron* deference and even congressional taxwriting committee reports. George K. Yin, "Textualism, the Authoritativeness of Congressional Committee Reports, and Stanley Surrey," 86 *Law & Contemp. Probs.* 107 (2023). There is only the hint of pushback from the elected branches, with unlikely schemes like court packing and term limits. An Article V, 21st Amendment-style state-led constitutional convention might restrain the judiciary appropriately.

²⁵Inessa Zlobina, "H.R. 6392 (117th Congress) — No Tax Breaks for Drug Ads Act," 12 *Contemp. Tax J.* 23 (Spring 2023).

²⁶There is extensive literature about options for a tax base for marijuana. See, e.g., Caulkins, *supra* note 3; Ulrik Boesen, "A Road Map to Recreational Marijuana Taxation," Tax Foundation Research (June 9, 2020). Oglesby, "Mistakes in 2011 'Laws to Tax Marijuana,'" Center for New Revenue (Jan. 28, 2015).

²⁷James E. Prieger et al., "Cannabis Potency Tax Feasibility Study: A Report for the Washington State Liquor and Cannabis Board," SSRN (Nov. 14, 2019).

²⁸Treasury Department, "Federal Excise Tax Increase and Related Provisions," Alcohol and Tobacco Tax and Trade Bureau (Jan. 9, 2019).

licensees, and medium-size businesses are less able, before and after tax, to afford digital ads or public view advertising like billboards²⁹ and display signs — or other marketing promotions that big business deploys. Despite their nondeductibility, billboards are in use already.

Also, small businesses typically lack the marketing know-how that corporate giants pay big bucks for. Think Budweiser ads. And recently, “\$1 out of every \$6 spent on restaurant advertising in America [was] done by McDonald’s.”³⁰ That does not account for Burger King or KFC. Mom and Pop rely on word of mouth, and traditional marijuana consumers are in the habit of relying on one another for information.

Big Marijuana wants to start deducting ad expenses — and Big Alcohol and Big Tobacco don’t like the section 280E precedent.

Still, in the aggregate, selling, general, and administrative expenses that section 280E disallows often represent a larger percentage of revenue for small businesses than for big businesses. Capital costs like interest expense tend to be higher for small businesses, for instance, and there will be a threshold amount of security costs, no matter how small the business is. Big businesses may be more likely to get quantity discounts on advertising and other marketing costs.

Competition From Cheaters

In states with legal marijuana, there is always a small or large unregulated, unlicensed, illicit market.³¹ Players in the illicit market not only don’t pay state marijuana taxes, but they are also likely to evade the section 280E tax and all federal income taxes.

Some states have marginalized their illicit markets to their satisfaction. Others have not, because (1) they enforce the law against lawbreakers too weakly, (2) their taxes and

regulations are too burdensome, or both.

California and New York recently not only cut tax rates but also shifted tax bases, from price-collapse-resistant weight- and THC-based taxes to an industry-favored ad valorem or price-based tax. But lawbreakers remain strong in those and other states.

The section 280E selling expense tax is a burden that, combined with state regulatory and tax burdens, makes it hard for the legal marijuana industry to compete with unlicensed illicit sellers, who we figure are tax evaders. Schedule III’s elimination of section 280E would come to the rescue of legal marijuana markets in states that have not marginalized illicit markets.

But illicit markets in some states seem satisfactorily marginalized, so tax burdens there, including the section 280E burden, may be reasonable. Overbroadly, Schedule III’s elimination of section 280E would apply to those stable markets — and even to state-illicit sellers of marijuana.

Competition From Hemp THC Sellers

Hemp and marijuana are both varieties of the cannabis sativa plant species. Delta-9 THC, the intoxicating ingredient in Schedule I’s marijuana, is the reason to tax it. Some of that same delta-9 THC was federally legalized inadvertently as hemp through a loophole in the 2018 Farm Bill — a technicality.³² Hemp THC drugs are in no federal schedule, so they escape section 280E. (A historical note — like section 280E’s burden on state-legal marijuana, federal legalization of hemp THC drugs was not on Congress’s radar screen.)

So hemp THC drug law has been left to the states so far. States have adopted three approaches to these federally unscheduled, unregulated hemp THC drugs. Some states ban

²⁹ Oglesby, “Ads and 280E,” Center for New Revenue (Apr. 8, 2020).

³⁰ Kim Bhasin, “This One Statistic Shows Just How Much McDonald’s Tries to Entrench Itself in Everybody’s Minds,” *Business Insider* (Mar. 14, 2012).

³¹ We can’t eliminate the illicit market. We can hope only to reduce it to a tolerable level. Oglesby, “The Optimal Amount of Crime Is Not Zero,” Center for New Revenue (May 29, 2015).

³² The chemistry of delta-9 and of other intoxicants is complicated. Long story short, the 2018 Farm Bill legalized products with under 0.3 percent delta-9 THC by dry weight. Intoxicating THC in hemp drugs in the form of gummies, sodas, and so on can easily come in under the Farm Bill’s 0.3 percent limit. And much intoxicating smoked delta-9 THC is created from another cannabinoid, THC-A, only after combustion, and is measurable only then. Delta-8 THC and other intoxicants were legalized by the Farm Bill, too. Mike Riggs, “Congress Accidentally Legalized Weed Six Years Ago,” *The Atlantic* (July 15, 2024); Oglesby, “Intoxicating THC Is Openly Sold in North Carolina,” Center for New Revenue (Feb. 6, 2024). This loophole may make Congress think it doesn’t know how to legislate about marijuana and hemp.

them. Some states impose taxes and regulations and require licenses. Some states impose no restrictions, so the market is wide open to all comers 24-7.

No hemp THC drug sales today are subject to section 280E. So any state-legal marijuana industry is at a direct competitive federal tax disadvantage to state-legal Farm Bill hemp THC drug sellers.

Hemp THC drug sellers don't deserve that tax advantage, but it pales in comparison with other federal advantages they enjoy today. Hemp sellers — unlike state-siloed marijuana sellers — can operate in interstate commerce; hemp sellers — unlike randomly tested marijuana sellers — can sell to kids; hemp sellers — unlike regulated marijuana sellers — can sell untested products, use banks normally, receive bankruptcy protection, benefit from state excise tax exemption, and much more. Those disparities favoring hemp THC over marijuana THC emerge unscathed under schedules II and III. So section 280E is just one of several forces tilting the playing field, and seems much less important than, for instance, interstate commerce.³³ Eliminating just the *tax* disadvantage by disabling section 280E is like defending against a swarm of hornets with a fly swatter.

Ideally, the federal government would tax Farm Bill hemp THC drug sellers like marijuana THC sellers. That ideal — tax parity — would subject all THC sellers to section 280E, or none of them. So if hemp THC drugs were put into Schedule I, they would be taxed like marijuana is today, with section 280E.³⁴ Alternatively, if hemp THC drugs and marijuana were both put into Schedule III, neither would be subject to section 280E. Either way, there would be parity.

What if hemp THC drugs were simply federally prohibited rather than scheduled? Under prohibition rather than scheduling, hemp

THC drugs would continue to be free of section 280E. Their tax advantage would continue unless marijuana were moved to Schedule III.³⁵

What about the states that ban sales of hemp THC drugs, or limit them to niche products that don't compete seriously with licensed marijuana sellers? Overbroadly, Schedule III's elimination of section 280E would apply in those states, too.

What About Congress?

In a better world, a functional Congress would solve the national debt problem and then address capillaries of the law such as establishing legal parity between hemp THC and psychoactively equivalent marijuana THC — not just for taxes, but for everything. In that process, for taxation, Congress might keep and improve section 280E. For example, why not allow deductions for employee compensation, at least up to a living-wage threshold?

Legislation is much harder to challenge in court than administrative actions like rescheduling. The recent repudiation of the *Chevron* doctrine — which deferred to executive interpretations of statutes — in the *Loper Bright*³⁶ case makes administrative actions even more at risk of challenges in court. So congressional rather than administrative action is the way to go.

But the oversight that caused the hemp drug THC loophole should make an already fairly dysfunctional federal legislative branch reluctant to touch THC drugs again — like a burnt child fearing the flame. And the details of legalizing are plenty hard — certainly the tax part is. Thus, Congress, which hasn't seen fit even to regularize banking for marijuana sellers, seems unlikely to act broadly and boldly in the near or medium term to seek parity among THC drugs.

³³ The playing field is tilted against hemp drug sellers at the state level to the extent they can't become licensed marijuana sellers.

³⁴ Putting both sets of THC drugs into Schedule II ("high potential for abuse, with use potentially leading to severe psychological or physical dependence") would mean both are subject to section 280E.

³⁵ The written laws are not the only issue for hemp drugs. Enforcement matters too. Maybe federally prohibited or scheduled hemp THC drugs would enjoy general federal enforcement forbearance, as state-legal Schedule I marijuana THC drugs do today. That federal forbearance is hard to predict. Federal forbearance would appear most suitable in states that affirmatively regulate hemp THC drugs, somewhat less suitable in states that have ignored them, and least suitable in states that have banned them. Federal forbearance for sellers of hemp THC drugs may happen whether they are scheduled or prohibited. But even marijuana-like forbearance would shake the hemp industry to its foundations because it operates intensively in interstate commerce, which federal forbearance has not allowed for marijuana.

³⁶ *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244 (2024).

As opposed to legislative action, administrative action to deal with section 280E and marijuana generally is a blunt and unwieldy instrument. It “proceeds via formal rulemaking, which generally takes months or years to complete. . . . By contrast, Congress is not bound by the CSA’s [Controlled Substances Act’s] substantive or procedural requirements. . . . The CSA provides DEA with limited options for regulating controlled substances.”³⁷ To be regulated administratively, every drug must fit or at least be put into a predefined statutory set of rules.

But with Congress dysfunctional and unable to act, the executive branch is stepping up and filling the void.

Conclusion

Let’s say the federal government wants to tax marijuana despite the state-legal industry’s competitive struggles. For public health, the section 280E selling expense tax may be the best marijuana tax available.

With Congress chronically enfeebled, the fate of section 280E is up to the Biden administration. A good marijuana tax is hard to find, so it would be sad to see Congress’s pro-public-health, revenue-positive section 280E selling expense tax die by marijuana’s administrative transfer to Schedule III. However, marijuana’s transfer to Schedule II instead of Schedule III would keep the marijuana selling expense tax revenue coming in and would keep section 280E’s unfinished tax experiment running. ■

³⁷ Lampe, “Legislative Scheduling of Controlled Substances,” Congressional Research Service IF12709 (July 9, 2024). *Accord*, Mikos, *supra* note 2.

taxanalysts®

Education | Debate | Fairness | Transparency



We’re on a mission.

Shining a light on unfair tax policies and pushing for a level playing field, we work every day to strengthen open government and fairness in tax systems.

We publish world-class news and analysis, host and provide speakers for conferences on topics that matter, provide material for free on our site, and pursue the release of important public information through the Freedom of Information Act.

Find out more at
taxnotes.com/free-resources.