

Setting the Stage for Cannabis Reform or Just Blowing Smoke



East Valley Bar Association
March 15, 2024



**Josephine Giordano, MBA, CPA, ABV, CFF,
CFE, CBA, ASA, CDBV, CIRA, CICA, CTP, CCCE**

Session Description & Objectives

It will take some time to understand the full impact of rescheduling. This session will address the potential upsides and downsides of the stages of cannabis reform and their impact on cannabis businesses.

Let's Start with an Arizona Update

- Sales started strong in 2023, continuing the rapid growth Arizona operators have experienced since launching regulated adult-use marijuana in 2021.
- Monthly recreational marijuana sales for 2023 peaked in March at \$100 million.
- The months long decline in sales since March is a worrying trend for a marijuana market that still should be growing, based on trends seen in other states.
- Year-over-year growth through October 2023 was 14%, compared with 44% for the same period between 2021 and 2022.
- Observers can expect some minor upward adjustments in late 2023 sales numbers, as state calculations are based on tax collections that often lag by a couple of months.

<https://mjbizdaily.com/state-by-state-review-of-adult-use-marijuana-sales-2023/>

AZ Medical Marijuana Program Update

The Arizona Medical Marijuana Act (AMMA) went into effect on April 14, 2011, making Arizona the fourteenth state to adopt a medical marijuana law.

Qualifying Patients:

| 1/2024 | 12/2023 | 12/2022 | 12/2021 | 12/2020 | 12/2019 | 12/2018 | 12/2017 | 12/2016 | 12/2015 |
|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| 113,694 | 115,914 | 129,836 | 266,850 | 295,295 | 219,817 | 186,002 | 152,979 | 114,439 | 87,733 |

As of January 2024, 94% of cardholders list chronic pain as qualifying health condition.

Qualifying patients dramatically dropped by 61% from December 2020

<https://www.azdhs.gov/licensing/medical-marijuana/>



Medical Marijuana Program Update

| | Medical Sales | | | Medical TPT Tax | | |
|-----------------|----------------------|----------------------|----------------------|---------------------|---------------------|---------------------|
| | 2021 | 2022 | 2023 | 2021 | 2022 | 2023 |
| January | \$42,496,049 | \$55,450,827 | \$29,937,959 | \$3,556,838 | \$4,637,773 | \$2,479,837 |
| February | \$55,560,178 | \$58,554,149 | \$29,944,288 | \$4,671,094 | \$4,876,733 | \$2,484,019 |
| March | \$73,050,373 | \$56,312,585 | \$33,734,242 | \$6,158,215 | \$4,711,320 | \$2,789,171 |
| April | \$73,410,962 | \$51,987,604 | \$31,509,534 | \$6,155,465 | \$4,350,447 | \$2,611,788 |
| May | \$70,687,461 | \$46,494,358 | \$30,412,120 | \$5,927,956 | \$3,879,902 | \$2,530,146 |
| June | \$65,432,732 | \$40,471,882 | \$29,180,167 | \$5,485,810 | \$3,390,197 | \$2,416,791 |
| July | \$71,614,558 | \$38,939,108 | \$27,820,419 | \$6,005,446 | \$3,250,452 | \$2,295,168 |
| August | \$65,777,545 | \$36,235,733 | \$29,244,151 | \$5,502,424 | \$3,023,456 | \$2,423,147 |
| September | \$64,086,674 | \$33,482,625 | \$28,115,989 | \$5,364,389 | \$2,800,656 | \$2,324,092 |
| October | \$64,454,676 | \$33,393,923 | \$26,037,097 | \$5,381,510 | \$2,787,614 | \$2,144,018 |
| November | \$60,262,446 | \$32,526,244 | \$25,991,682 | \$5,015,766 | \$2,689,531 | \$2,143,763 |
| December | <u>\$57,525,283</u> | <u>\$34,471,257</u> | <u>\$24,904,499</u> | <u>\$4,823,014</u> | <u>\$2,848,094</u> | <u>\$2,060,700</u> |
| Totals | \$764,358,937 | \$518,320,295 | \$346,832,147 | \$64,047,927 | \$43,246,175 | \$28,702,640 |
| % Change | | -32% | -33% | | -32% | -34% |



According to ADOR’s Office of Economic Research and Analysis, medical marijuana taxable sales and TPT tax for the 12 months ended December 2023 decreased 33% and 34%, respectively compared to the same period in 2022.

<https://azdor.gov/reports-statistics-and-legal-research/marijuana-tax-collection>

Adult Use Update



| | Adult Use Sales | | | Adult Use TPT Tax | | | Adult Use Excise Tax | | |
|-----------------|----------------------|----------------------|------------------------|---------------------|---------------------|---------------------|----------------------|----------------------|----------------------|
| | 2021 | 2022 | 2023 | 2021 | 2022 | 2023 | 2021 | 2022 | 2023 |
| January | \$7,664,486 | \$63,074,423 | \$84,566,852 | \$626,204 | \$5,305,446 | \$7,088,247 | \$1,851,395 | \$11,362,708 | \$14,598,873 |
| February | \$32,368,926 | \$73,854,128 | \$82,291,577 | \$2,771,091 | \$6,165,345 | \$6,893,347 | \$6,491,298 | \$11,653,748 | \$14,218,149 |
| March | \$50,785,650 | \$74,330,931 | \$93,366,390 | \$4,312,012 | \$6,252,239 | \$7,793,730 | \$9,707,440 | \$13,467,748 | \$16,264,447 |
| April | \$53,961,930 | \$74,422,013 | \$88,104,358 | \$4,556,220 | \$6,248,846 | \$7,371,387 | \$9,844,932 | \$13,594,676 | \$14,969,012 |
| May | \$53,239,517 | \$73,926,259 | \$86,749,019 | \$4,499,403 | \$6,189,060 | \$7,216,853 | \$9,867,197 | \$12,853,941 | \$14,538,683 |
| June | \$51,450,586 | \$70,633,969 | \$82,585,478 | \$4,354,929 | \$5,911,769 | \$6,922,376 | \$9,244,919 | \$12,472,569 | \$14,184,902 |
| July | \$54,940,119 | \$74,325,146 | \$77,845,042 | \$4,630,565 | \$6,231,178 | \$6,520,762 | \$9,697,111 | \$12,942,714 | \$13,143,315 |
| August | \$52,217,296 | \$74,488,618 | \$81,747,094 | \$4,404,214 | \$6,237,263 | \$6,850,162 | \$9,418,977 | \$12,818,623 | \$13,989,478 |
| September | \$53,902,618 | \$75,735,130 | \$83,194,727 | \$4,550,256 | \$6,340,376 | \$6,965,843 | \$9,634,375 | \$13,191,921 | \$13,812,139 |
| October | \$59,104,156 | \$78,486,562 | \$82,115,244 | \$4,971,879 | \$6,557,846 | \$6,864,372 | \$10,721,779 | \$13,727,177 | \$13,873,046 |
| November | \$59,525,760 | \$80,179,770 | \$83,598,178 | \$4,992,041 | \$6,675,740 | \$6,995,282 | \$10,656,933 | \$13,911,139 | \$14,016,071 |
| December | <u>\$69,671,031</u> | <u>\$87,623,853</u> | <u>\$83,957,933</u> | <u>\$5,828,690</u> | <u>\$7,321,813</u> | <u>\$7,034,173</u> | <u>\$11,735,551</u> | <u>\$14,958,388</u> | <u>\$13,506,761</u> |
| Totals | \$598,832,075 | \$901,080,802 | \$1,010,121,892 | \$50,497,504 | \$75,436,921 | \$84,516,534 | \$108,871,907 | \$156,955,352 | \$171,114,876 |
| % Change | | 50% | 12% | | 49% | 12% | | 44% | 9% |

According to ADOR’s Office of Economic Research and Analysis, medical marijuana taxable sales, TPT tax, and excise tax for the 12 months ended December 2023 increased 12%, 12%, and 9%, respectively compared to the same period in 2022.

<https://azdor.gov/reports-statistics-and-legal-research/marijuana-tax-collection>

HHS Recommendation

The U.S. Department of Health and Human Services (HHS) has recommended that DEA move marijuana from Schedule I to Schedule III of the CSA following a scientific review that concluded cannabis does have therapeutic applications and is less harmful than other controlled substances on lower schedules. DEA makes the final decision, however, and is not bound by the HHS recommendation.

If this recommendation is adopted, would doctors be able to write prescriptions for marijuana products; such as flowers, concentrates, topicals and edibles? The answer is “maybe,” because federal regulations put it in a gray area.

<https://www.marijuanamoment.net/senators-tell-dea-to-fully-legalize-marijuana-demanding-answers-on-rescheduling-process> <https://www.coloradopolitics.com/opinion/rescheduling-medical-marijuana-opens-pandora-s-box-opinion/article>



Schedule III

Schedule III is reserved for substances with a moderate to low abuse potential, a currently accepted medical use, and a low potential for psychological dependence. Use of a Schedule III substance requires a prescription, which may not be filled six months after its date or more than five times total unless renewed by a practitioner.

Examples include:

- Tylenol with Codeine
- Suboxone
- Ketamine
- Anabolic steroids drugs

Some examples of substances listed in Schedule I are heroin, lysergic acid diethylamide (LSD), marijuana, peyote, methaqualone, and 3,4-methylenedioxymethamphetamine (“Ecstasy”).

<https://www.mcglinchey.com/insights/rescheduling-marijuana-understanding-the-legal-impacts/>



Schedule III

Rescheduling marijuana under the CSA would not legalize the sale of marijuana for recreational use, nor would it legalize marijuana products – such as flower, edibles, vapor products, topicals, or anything besides FDA-approved drugs in specific forms that have been tested and approved.

To illustrate this point, consider what would happen if a drug currently listed in the CSA Schedules were sold in the same manner as marijuana. For example, Xanax is a Schedule IV drug. To legally use Xanax, an individual must receive a prescription from their doctor and then purchase the drug from a pharmacy. The pharmacy will provide the drug with a valid prescription and in the amounts provided in the prescription. If Xanax was sold like state-legal marijuana in this hypothetical scenario, Xanax would be sold in Xanax dispensaries. Those dispensaries would sell Xanax they obtained from state-legal Xanax manufacturers. The Xanax in one state might differ from the Xanax in another state. In some states, you would need a recommendation from a doctor to use medical Xanax, while in others, you would be free to use Xanax recreationally. This example is not an attempt to advocate for recreational Xanax use. Instead, it's a comparison intended to show that state-legal marijuana markets are not designed to comply with federal drug laws.

<https://www.mcglinchey.com/insights/rescheduling-marijuana-understanding-the-legal-impacts/>



Violation of International Treaties?

A group of lawyers argue in a newly released legal opinion that contrary to what the Drug Enforcement Administration (DEA) has asserted in the past, international drug treaties ought not stand in the way of moving marijuana to Schedule III of the Controlled Substances Act (CSA), as the Department of Health and Human Services (HHS) has recommended.

The opinion argues, a move to Schedule III would better uphold the country's broader obligations under international law to regulate cannabis in a way that protects public health and safety.

<https://www.marijuanamoment.net/moving-marijuana-to-schedule-iii-would-not-violate-international-treaties-legal-opinion-says/>



Tax Impact

If the DEA adopts HHS' recommendation, cannabis businesses no longer would be subject to the prohibitions under IRC Section 280E, which would significantly lower the income tax burden for cannabis businesses and lead to greater profitability and equity with other legal businesses.

Cannabis businesses would have to evaluate the financial statement impact of no longer being subject to IRC Section 280E. The effect on a business's income tax provision could be significant, as deferred tax assets and liabilities would have to be considered once they no longer are subject to Section 280E. In addition, any accounting method changes would need to be accounted for and treated properly for financial statement purposes.

<https://www.crowe.com/insights/tax-news-highlights/rescheduling-marijuana-could-provide-280e-tax-relief>



A Rescheduling is not a De-scheduling

It is equally important to underscore that a rescheduling is not a de-scheduling. Marijuana will remain federally illegal. Consequently, the ban on interstate commerce for state-legal cannabis companies remains in place. Even if rescheduled to Schedule III, it remains illegal at the federal level to manufacture, distribute, and retail such a drug without a prescription or DEA registration. There is currently no process for cannabis prescriptions, nor will there be a process set forth for this for quite some time. We are unlikely to see Food and Drug Administration (“FDA”)-approved cannabis drugs in the stream of commerce any time soon. In other words, state-licensed cannabis medical products will not automatically qualify as approved Schedule III cannabis drugs. The rescheduling will not alter how the state-legal cannabis industry operates, but this rescheduling does lead to some interesting new options for the future, including increased access to medical research and development.

<https://www.gmlaw.com/news/cannabis-rescheduling-deep-dive-part-i-introduction-impact-on-state-legal-businesses/>



What About Past Taxes?

It is not clear whether the rescheduling will be retroactive, but it is unlikely that would be the case. Consequently, there would be no relief from past taxes paid under the 280E regime.

<https://www.crowe.com/insights/tax-news-highlights/rescheduling-marijuana-could-provide-280e-tax-relief>



What If 280E is Declared Unconstitutional?

There Is Litigation in the Courts Challenging the Constitutionality of Section 280E. What Happens to the Taxes Paid If 280E Is Declared Unconstitutional?

Answer: It is hard to say how the courts will rule on this issue. But one thing is for sure: There is a statute of limitations for filing a claim for refund, and if a claim is not filed within that statute (generally the later of two years after the date of payment of the tax or three years from the date the tax return was filed) there will be no refund available. So, file claims for refund now—a “protective claim”—to avoid losing out if 280E is declared unconstitutional.

https://www.duanemorris.com/alerts/tax_implications_reclassifying_cannabis_schedule3_controlled_substance_



Trulieve Announces Filing of Amended Federal Tax Returns Claiming \$143 Million Refund

TALLAHASSEE, Fla., Oct. 13, 2023 /PRNewswire/ -- Trulieve Cannabis Corp. (CSE: TRUL) (OTCQX: TCNNF) ("Trulieve" or "the Company"), a leading and top-performing cannabis company in the United States, today announced the filing of amended federal tax returns with refund claims for several of the Company's business entities for the years 2019, 2020, and 2021. In total, the Company is claiming a refund of \$143 million from taxes paid which the Company believes it does not owe, although there is no guarantee of receipt. This determination is supported by legal interpretations that challenge the Company's tax liability under Section 280E of the Internal Revenue Code.

<https://www.prnewswire.com/news-releases/trulieve-announces-filing-of-amended-federal-tax-returns-claiming-143-million-refund>



Trulieve Cannabis reports receiving \$113 million in 280E tax refunds

February 29, 2024 - In a fourth-quarter earnings report, Trulieve said it has:

- Received \$62 million worth of tax refunds during the quarter ended Dec. 31.
- Received “a total of \$113 million in refunds to date,” including \$50.3 million received in January 2024.
- Received “one rejection notice in the amount of \$1.2 million.”

Trulieve did not specify whether the successful or rejected refunds came from the federal government or state governments.

Trulieve CEO Kim Rivers said she couldn't reveal more details about what she called a “trade secret” but added that the company considers the tax refund strategy to be “in large part specific to our position and our organization.”

<https://mjbizdaily.com/trulieve-cannabis-reports-receiving-113-million-in-280e-tax-refunds/>



FDA Approval?

- If marijuana was moved to Schedule III, could the FDA unilaterally approve it, and declare it a “safe and effective drug?”
- No, because obtaining FDA approval is a rigorous process, typically taking years, as Phase 1-4 clinical trials are conducted with only 13.8% of drugs submitted receiving final approval. Clinical trials are expensive and may require the participation of thousands of volunteer subjects, in order to find out if a drug is truly safe and effective. Even after approval, drugs may be subject to recall, and indications for use made more restrictive. There is no quick and easy path to FDA approval.

<https://www.coloradopolitics.com/opinion/rescheduling-medical-marijuana-opens-pandora-s-box-opinion/article>



Interstate Commerce

Some cannabis executives are hopeful that if the federal government moves marijuana from Schedule 1 to 3 of the Controlled Substances Act, then transporting MJ products across state lines will be allowed.

Schedule 3 (as well as Schedules 4 and 5) permits interstate commerce only for drugs approved by the U.S. Food and Drug Administration, such as anabolic steroids, ketamine, testosterone and Tylenol with codeine – plus dronabinol, Marinol and Syndros, which are synthetic THC formulations used to increase appetite in patients undergoing chemotherapy or suffering from anorexia.

Would flower, concentrates, THC-infused edibles and other products sold at medical marijuana dispensaries and adult-use retailers be permitted for interstate commerce?

Not legally, unless they have FDA approval.

<https://mjbizdaily.com/how-will-rescheduling-impact-interstate-commerce-for-marijuana/>



Interstate Commerce

While non-FDA-approved marijuana products would still be federally illegal, many observers believe the plant's rescheduling would make federal authorities less inclined to target cannabis businesses that transact cross-border sales.

And if states have implemented agreements that allow for interstate commerce under certain conditions – think California, Oregon and Washington – the federal government will be even less likely to interfere when marijuana is at Schedule 3, some observers reason.

California, Oregon and Washington all have passed interstate commerce laws that permit licensed cannabis businesses to transport THC products across state lines and into other regulated markets – but only if the federal government legalizes marijuana or its interstate commerce.

If rescheduling happens, “then immediately there’s a lot of positive sentiment toward pushing for interstate commerce.

<https://mjbizdaily.com/how-will-rescheduling-impact-interstate-commerce-for-marijuana/>



States create marijuana interstate commerce law

Washington Gov. Jay Inslee signed into law a bill that allows legal-market marijuana to be transported across state lines to other legal MJ markets. Oregon's governor signed into law a similar interstate commerce bill in 2019, as did California's in 2022.

However, the law is contingent on the U.S. government legalizing marijuana on a federal basis or allowing interstate commerce for MJ products.

<https://mjbizdaily.com/washington-becomes-3rd-state-to-create-marijuana-interstate-commerce-law>



Flooding of Markets

“A lot of states probably are plenty fearful that California products flooding into their market will immediately plunge the prices of goods, which would actually hurt the domestic market within a particular state”

In those situations, states concerned about tumbling prices would probably seek to impose import and export tariffs – as well as interstate commerce taxes – to shield their local cannabis industries.

<https://mjbizdaily.com/how-will-rescheduling-impact-interstate-commerce-for-marijuana/>



Bankruptcy Protection

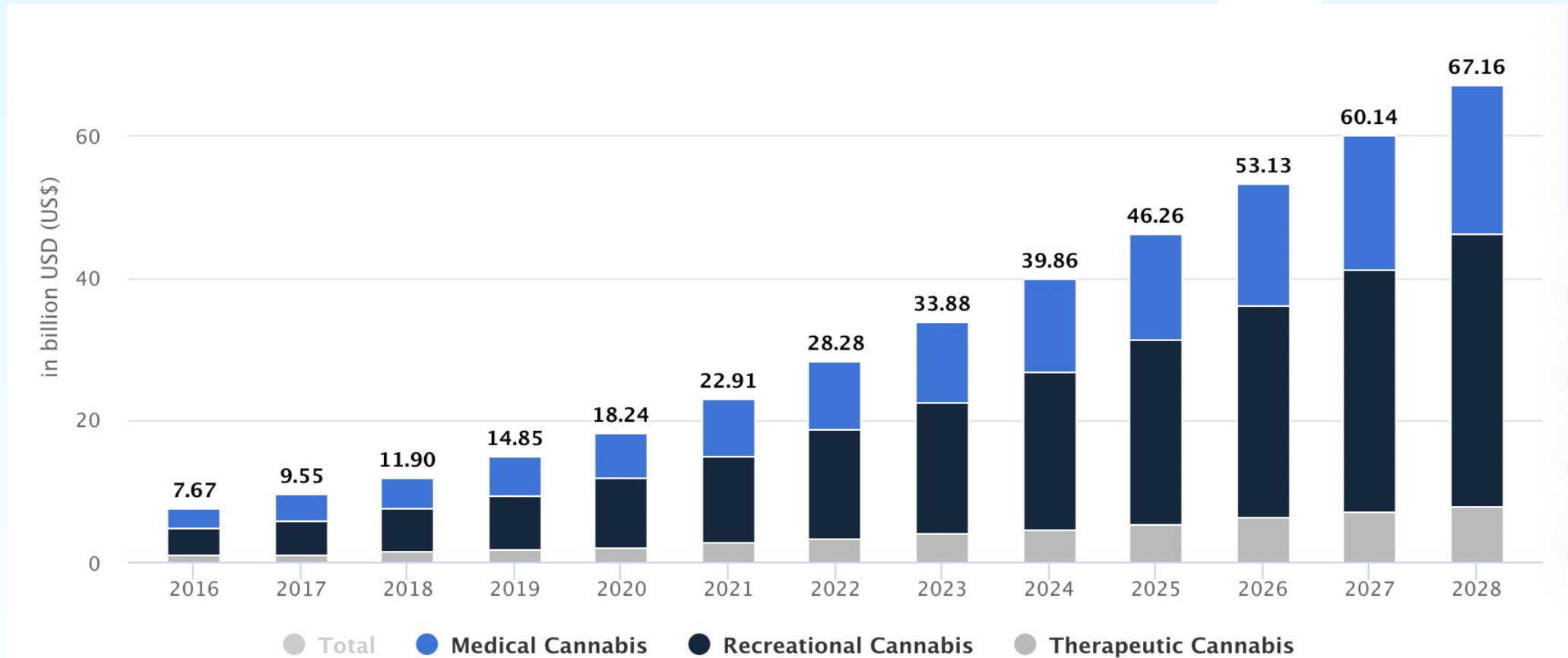
In a landmark decision, the court in *In re Hacienda Co., LLC*, No. 2:22-BK-15163-NB, 2023 WL6143217 (Bankr. C.D. Cal. July 11, 2023) confirmed a California cannabis company’s bankruptcy plan of reorganization, staving off pressing creditors and enabling it to raise working capital through gradually selling off shares.

Forming one of the first federal rulings to provide an MRB with bankruptcy relief, the Hacienda opinion provides a road map for cannabis growers, processors, transporters or sellers to pursue “reorganization.”

Cannabis Products Insider – “Landmark case could open cannabis Industry’s access to bankruptcy protection “



Market Opportunity



The US cannabis industry is expected to reach almost \$40 billion in 2024

<https://flowhub.com/cannabis-industry-statistics>



QUESTIONS

Thank you!

Josephine Giordano

CPA, ABV, CFF, CFE, CBA, ASA, CDBV, CIRA, CICA, CTP, CCCE

jgiordano@beachfleischman.com

602-792-5981



BeachFleischman PLLC • beachfleischman.com

1985 E. River Rd., Suite 201, Tucson, AZ 85718-7176 • 520.321.4600

2201 E. Camelback Rd., Suite 200, Phoenix, AZ 85016-3431 • 602.265.7011

About the Speaker

Josephine Giordano CPA, ABV, CFF, CFE, CBA, ASA, CDBV, CIRA, CICA, CTP, CCCE is the National Cannabis Practice Leader and a Director in the Financial Forensics and Business Valuation Services Group with **BeachFleischman PLLC**. She is founder and Chairperson of the Arizona Society of CPA's (ASCPA) Cannabis Special Interest Section. She has authored several articles, including the ASCPA's monthly *Bud Brief*, as well as presented and provided training on cannabis-related topics. She serves as an Education Advisory Board member of the Association of Certified Commercial Cannabis Experts and is a member of the Public Policy Committee of the Arizona Cannabis Chamber of Commerce. She provides tax, audit, financial and operational consulting, risk assessment, business valuation, forensic accounting, turnaround management and litigation support services. Josephine can be reached at jgiordano@beachfleischman.com or 602-792-5981.