

# DEA Proposes to Reschedule Marijuana, but Impact for Financial Services Likely Limited

May 10, 2024

Following an August 2023 recommendation from the Department of Health and Human Services (“HHS”), the Drug Enforcement Administration (“DEA”) reportedly will seek to reclassify marijuana from Schedule I of the federal Controlled Substances Act (the “CSA”) to Schedule III, which would recognize the use of marijuana for medical purposes.

Marijuana has been classified as a Schedule I controlled substance for over 50 years, and its rescheduling would represent a significant shift in U.S. drug policy. The near-term impact for financial institutions considering whether to serve the marijuana sector is likely limited, however, as reclassification to Schedule III would not legalize recreational marijuana and would require medical marijuana businesses to comply with various regulatory requirements at the federal level. The proposed marijuana reclassification is also subject to federal rulemaking and, therefore, will not take immediate effect.

We describe below certain legal implications associated with reclassifying marijuana to Schedule III of the CSA along with a number of procedural considerations.<sup>1</sup>

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## Implications of Reclassifying Marijuana from Schedule I to Schedule III

### How is DEA proposing to change the legal status of marijuana?

- DEA reportedly plans to propose the reclassification of marijuana from Schedule I to Schedule III of the CSA. The CSA classifies substances in five schedules based on their medical use, potential for abuse, and safety or risk of dependence.

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<sup>1</sup> This Debevoise in Depth does not address hemp, which was removed from Schedule I of the CSA by the Agriculture Improvement Act of 2018 and about which we have written previously. See, e.g., David Sarratt et al., *2018 Farm Bill to Lift Federal Prohibition on Hemp Production, but State Laws May Restrict Certain Activities*, DEBEVOISE & PLIMPTON LLP (Dec. 13, 2018), available [here](#); Satish M. Kini et al., *Cannabis and Hemp: Regulatory Green Light or Still a Pipe Dream?*, AM. BAR ASS'N BUS. L. TODAY (Apr. 15, 2019), available [here](#); Satish M. Kini et al., *USDA Issues Long-Awaited Hemp Production Regulations*, DEBEVOISE & PLIMPTON LLP (Oct. 31, 2019), available [here](#).

Marijuana's current classification in Schedule I<sup>2</sup> means that it is considered to have a high potential for abuse and no currently accepted medical use. As a result, its manufacture, distribution and possession are currently illegal under federal law. Schedule III substances, on the other hand, have a moderate to low potential for physical and psychological dependence and a lesser risk of abuse.<sup>3</sup> Schedule III substances may be authorized for accepted medical uses and dispensed by prescription.<sup>4</sup>

### Does the proposed rescheduling mean that the United States is legalizing marijuana?

- No. Schedule III drugs must be approved by the Food and Drug Administration ("FDA") and are also regulated as controlled substances. Removing marijuana from Schedule I would reduce some restrictions under the CSA related to medical marijuana, but recreational marijuana use would remain illegal at the federal level.
- Among other impacts, reclassifying marijuana to Schedule III would mean that marijuana products could be approved by FDA as drugs and prescribed for accepted medical uses.<sup>5</sup> Although FDA has approved some marijuana-related drugs, marijuana itself is currently not approved for medical use.<sup>6</sup> In addition, manufacturers and distributors of any FDA-approved marijuana drugs would need to comply with a number of DEA regulatory requirements.
- Rescheduling marijuana would not impact the manufacture, distribution and possession of recreational marijuana, which would remain illegal under federal law and subject to federal prosecution.<sup>7</sup>

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<sup>2</sup> See 21 U.S.C. § 812(c). Other Schedule I substances include heroin, LSD and ecstasy.

<sup>3</sup> These substances currently include Tylenol with codeine, ketamine and anabolic steroids.

<sup>4</sup> See 21 U.S.C. § 829(b).

<sup>5</sup> A move to Schedule III also could expand research and testing of marijuana, and individuals who use medical marijuana lawfully may face fewer barriers related to accessing public housing, obtaining immigrant and nonimmigrant visas, seeking federal employment and serving in the military.

<sup>6</sup> FDA has already approved drugs derived from or related to marijuana, but the agency has not, to date, approved any drug application for marijuana itself. As of March 2024, FDA had over 150 active commercial and research investigational new drug applications evaluating marijuana and marijuana-derived products. See FDA, *FDA's 50 Years of Experience with Cannabis Research Helping to Support Tomorrow's Cannabis Drug Development* (Mar. 20, 2024), available [here](#).

<sup>7</sup> In addition, absent action by Congress, other provisions of the CSA that apply specifically to marijuana will remain in effect following any reclassification to Schedule III. See, e.g., 21 U.S.C. § 823(c) (special registration requirements for manufacturers of marijuana for research purposes); 21 U.S.C. § 841(b)(1) (mandatory prison sentences for CSA violations involving set quantities of marijuana).

## Will it become legal for financial institutions to serve marijuana businesses?

- As noted above, even if marijuana is reclassified to Schedule III, recreational marijuana would remain illegal under federal law. In addition, use of marijuana for medical purposes would need to comply with FDA and DEA requirements related to the approval of drug products and regulation of controlled substances.
- As a result, rescheduling marijuana would not immediately obviate the potential legal risks to financial institutions of aiding and abetting CSA violations and/or violating anti-money laundering laws by handling illicit proceeds generated by marijuana businesses operating in violation of federal law. It may be possible for financial institutions to avoid these risks in serving companies engaged in permissible medical marijuana activities, but such companies would need to operate in compliance with FDA and DEA requirements to which they are not currently subject. As a consequence of the existing risks, many institutions have shied away from providing financial services to marijuana businesses, and rescheduling marijuana may not meaningfully impact the financial industry's willingness to serve such businesses.
- A congressional appropriations rider barring the Department of Justice from using taxpayer funds to prevent states from implementing their own medical marijuana laws currently prohibits federal prosecution of state-legal activities involving medical marijuana. However, the rider does not remove criminal liability and, although Congress has passed it in each budget cycle since 2014, the rider could lapse or be repealed. Further, the rider does not prohibit federal prosecution of activities related to recreational marijuana.
- Legislation to provide protections to certain federally regulated financial institutions serving state-sanctioned marijuana businesses is pending in Congress.<sup>8</sup> However, not all financial services would benefit from the proposed safe harbor under the bill, and efforts to enact such legislation since its first introduction several years ago continue to face opposition.

## Will marijuana businesses benefit from a reclassification of marijuana to Schedule III?

- Yes, moving marijuana to Schedule III would allow marijuana businesses to deduct certain business expenses on their federal tax returns. Section 280E of the

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<sup>8</sup> See SAFER Banking Act, S. 2860, 118th Cong. (2023); Satish M. Kini et al., *Cannabis Banking Legislation Advances out of Senate Banking Committee*, DEBEVOISE & PLIMPTON FINREG AND FINTECH BLOG (Oct. 10, 2023), available [here](#).

Internal Revenue Code prohibits businesses from deducting or claiming tax credits in connection with expenses incurred in connection with the business of “trafficking” Schedule I and Schedule II controlled substances. Moving marijuana to Schedule III would allow marijuana businesses to deduct rent, payroll and other business expenses on their federal returns. This would apply to both medical and recreational marijuana businesses that file federal tax returns (notwithstanding that recreational marijuana activities would remain illegal).

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## Timing and Procedural Considerations

### Why is DEA taking this step now?

- In October 2022, President Biden directed that HHS and the Attorney General initiate the administrative process to review marijuana’s scheduling under the CSA.<sup>9</sup> HHS conducted a comprehensive scientific and medical evaluation and, in August 2023, recommended that DEA move marijuana to Schedule III.<sup>10</sup> HHS determined that marijuana has a potential for abuse less than the drugs in Schedules I and II of the CSA and has a currently accepted medical use in treatment. In addition, HHS found that abuse of marijuana may lead to moderate or low physical dependence, depending on exposure, and that the likelihood of serious outcomes for psychological dependence is low.
- State legalization of marijuana has become widespread and popular support for legalization continues to grow. Currently, 38 states and the District of Columbia have legalized medical marijuana, while 24 states and D.C. allow recreational use.<sup>11</sup>

### When will marijuana’s rescheduling take effect?

- DEA’s proposal to reschedule marijuana will be subject to the notice-and-comment rulemaking process, and a final rule is not likely for many months.
- Once DEA drafts a proposed rule, it must be submitted to The White House’s Office of Management and Budget (“OMB”), which can take up to 90 days to review the proposal. As of May 9, 2024, DEA had not yet made a formal submission to OMB.

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<sup>9</sup> See *Statement from President Biden on Marijuana Reform*, THE WHITE HOUSE (Oct. 6, 2022), available [here](#).

<sup>10</sup> See Letter from Rachel L. Levine, M.D., Assistant Sec’y for Health to Hon. Anne Milgram, Administrator, Drug Enf’t Admin. (Aug. 29, 2023), available [here](#) (providing the bases for HHS’s recommendation that DEA reclassify marijuana as a Schedule III substance).

<sup>11</sup> See *Cannabis Overview*, NAT’L CONF. ST. LEGIS. (Apr. 9, 2024), available [here](#).

- Following OMB approval, DEA's proposal will be published in the Federal Register and available for public comment for a specified time period (typically ranging from 30 to 90 days). The proposal is expected to generate significant public comment, which will be reviewed by DEA before a final rule is formulated and re-submitted to OMB.
- Final federal agency actions also are subject to congressional review, including review by a new Congress if adjournment of a session would otherwise limit the statutory 60-day review period.

### Can Congress change the legal status of marijuana?

- Yes. Congress could act to change the legal status of marijuana either before or after DEA issues a scheduling decision and regardless of the Biden Administration's scientific and medical assessment. Congress could move marijuana to a less restrictive schedule, create a new schedule or category for marijuana, or remove it from the CSA entirely.<sup>12</sup> Congress also could determine to impose more stringent controls on marijuana.<sup>13</sup> Although some members of Congress support efforts to reclassify marijuana or remove it from the CSA, others believe it should remain illegal due to concerns over negative implications of its use.

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## Next Steps

Rescheduling marijuana as contemplated would subject state-legal medical marijuana businesses to FDA and DEA requirements, while the conflict between federal and state law for participants in the medical marijuana sector is likely to persist as these agencies consider the steps needed to ensure medical marijuana products meet applicable regulatory standards.

At the same time, moving marijuana to Schedule III would not address conflicts between federal law and state laws authorizing recreational marijuana, which would remain illegal under the CSA.

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<sup>12</sup> See, e.g., States Reform Act of 2023, H.R. 6028, 118th Cong. (2023) (proposing the removal of marijuana from the scope of the CSA and instead regulating it like alcohol); Marijuana 1-to-3 Act of 2023, H.R. 610, 118th Cong. (2023) (proposing the rescheduling of marijuana to Schedule III).

<sup>13</sup> See, e.g., Stop Pot Act of 2023, H.R. 5323, 118th Cong. (2023) (proposing the withholding of 10% of the federal funds allocated to states in which recreational marijuana is legal under certain national highway programs).

As such, a change in marijuana's classification under the CSA would not immediately alter the legal risks to financial institutions considering whether to provide services to marijuana businesses and may not encourage financial institutions to serve the industry.

Nevertheless, a final DEA action to reclassify marijuana as a Schedule III substance would represent a significant change in U.S. policy, and additional developments to liberalize the U.S. position on marijuana could follow. Financial institutions should continue to monitor related regulatory and legislative developments as they consider their risk-based compliance approaches to this industry.

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Please do not hesitate to contact us with any questions.



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