

Frequently asked questions about the States Reform Act, a proposed marijuana bill
Rep. Nancy Mace (R-SC) unveiled the States Reform Act, a proposal to remove marijuana from the auspices of the federal Controlled Substances Act.

By Geoffrey Lawrence, Senior Policy Fellow, November 15, 2021

Today, Rep. Nancy Mace (R-SC) unveiled the States Reform Act, a proposal to remove marijuana from the auspices of the federal Controlled Substances Act. This fundamental change in U.S. drug policy would effectively remove most federal restrictions against marijuana and state-licensed marijuana businesses. Rep. Mace's bill goes on to set up a process whereby marijuana would be regulated at the federal level, like alcohol, and would allow for an interstate marijuana market among states that choose to participate.

The States Reform Act has garnered attention as the first prominent bill sponsored by a House Republican to end the federal prohibition of marijuana, which could help give the proposal some political advantage in its efforts to secure bipartisan support. Congressional Democrats have previously introduced various marijuana legalization proposals, including the Marijuana Opportunity Reinvestment and Expungement (MORE) Act, and currently have draft language for the Cannabis Administration and Opportunity (CAO) Act. At this time, however, many observers believe neither of the proposals being led by congressional Democrats will be able to secure the necessary Republican votes for passage in the Senate. Any marijuana legalization proposal would need to secure the support of at least 10 Senate Republicans in order to overcome a potential filibuster.

The States Reform Act proposed by Rep. Mace already carries at least six Republican co-sponsors, with more support expected. Thus, it's possible Mace's Republican-backed States Reform Act may be able to break some of the political gridlock and attract a broad, bipartisan coalition to implement this needed policy.

Below are a number of the frequently asked questions about marijuana legalization and Rep. Mace's proposed bill:

- **Would the States Reform Act make marijuana legal nationwide?**

The States Reform Act would remove marijuana and all cannabinoids from the federal Controlled Substances Act entirely, but marijuana would remain prohibited under many state versions of the Controlled Substances Act. To date, 20 states have removed marijuana from these laws for adult use and an additional 18 allow marijuana to be dispensed to qualified medical patients with a doctor's recommendation. In states that do not allow commercial marijuana activity or possession for certain individuals, those restrictions would remain in place unless and until those states make their own statutory changes. That means marijuana would remain widely prohibited in states without adult-use marijuana programs. Even if a resident purchases a marijuana product in a state where it is legal to do so, that resident would be prohibited from bringing that marijuana product into a state that retains a legal prohibition against marijuana.

- **What major complications affecting the legal marijuana industry would be changed by the States Reform Act?**

Marijuana's current classification as a Schedule 1 substance under federal law automatically triggers a wide range of limitations even for the state-legal marijuana industry. Federal anti-money laundering statutes and regulations [require financial institutions](#) to perform additional scrutiny over entities or transactions they have reason to believe could involve the trafficking or distribution of any Schedule 1 substance. This reporting is time-consuming and costly to perform and any financial institution that offers financial services to a marijuana business could also face aiding and abetting charges. As a result, many financial institutions have chosen not to offer accounts to businesses they believe are involved in the marijuana industry, even if they are fully licensed and compliant under state law. Federal regulation of financial institutions has also prevented new financial institutions from receiving deposit insurance and Federal Reserve accounts when those institutions aim to service the marijuana industry.

Similarly, all businesses that traffic in a Schedule 1 or Schedule 2 substance are precluded from claiming a deduction of their business expenses under the "Ordinary and Necessary" standard generally applicable to entities filing income taxes. Instead, Internal Revenue Code Section 280E allows these entities to deduct only the Cost of Goods Sold from their Gross Income when calculating federal income tax liabilities. The result is that state-legal marijuana businesses are [penalized on their federal income tax](#) and must pay that tax on a modified gross receipts basis. Even marijuana businesses that operate at a loss may face substantial income tax liabilities.

Removing marijuana from the Controlled Substances Act entirely, as the States Reform Act would do, automatically solves these issues and allows state-legal marijuana

companies to access financial services and calculate federal income taxes just as similarly situated businesses in other legal industries

- **How would marijuana be regulated under the States Reform Act?**

The Alcohol and Tobacco Tax and Trade Bureau (TTB), a division of the Treasury Department, is designated as the primary regulatory body for marijuana by the States Reform Act. The TTB would be responsible for tracking all marijuana inventory through a seed-to-sale tracking platform similar to what is currently used by state regulatory systems administering adult-use marijuana programs. Typically, these platforms use radio frequency identification tags affixed to every plant or package containing a marijuana product and record all transfers of inventory at either the wholesale or retail level, and match declarations between buyers and sellers. These platforms are currently monitored by state regulators and allow them to run forensic data analytic programs to inspect for deviations in declared yields or conversions such that regulators can spot potentially illegal diversions of regulated inventory by any licensee. The TTB would track inventory in a fashion similar to existing state regulators and coordinate the transfer of any inventory between state regulatory systems in the event products are wholesaled between licensed marijuana businesses located in different states with marijuana programs in place.

As a partner to the TTB, the Bureau of Alcohol, Tobacco, Firearms and Explosives would be renamed to the Bureau of Alcohol, Tobacco, Cannabis, Firearms and Explosives and would investigate and potentially prosecute illicit trafficking in marijuana.

In sharp contrast to other proposals for federal legalization, the States Reform Act would specifically preclude extensive regulation of most marijuana products by the Food and Drug Administration. Section 201 stipulates that the FDA will have no more authority to regulate marijuana products than it does for alcohol unless a product is marketed as a medical product. These provisions will allow state regulatory systems to continue to address safety concerns, production methods, facility inspections and final product testing for potential impurities.

Sections 202 and 203 designate the federal Department of Agriculture as the appropriate regulator for the raw cannabis plant as it is growing. State licensing and regulations will continue in place for cannabis cultivation facilities, although state programs would additionally need to submit the details of their regulatory plan to the federal Department of Agriculture for approval, as is currently done with state hemp programs.

Finally, Section 206 of the States Reform Act creates a regulatory safe harbor for existing marijuana products so state-licensed businesses can continue selling these products before federal rulemaking is completed without fear of federal prosecution. This important protection even applies to state-licensed entities that engage in interstate commerce of regulated marijuana products, implying that states would be able to begin establishing interstate markets upon passage of the States Reform Act.

- **Could a consumer in one state order marijuana products from another state?**

The States Reform Act creates a pathway for consumers in states with adult-use marijuana programs to purchase or order products they like from other states with adult-use marijuana programs. Upon receipt of a federal license from TTB, marijuana companies will gain the ability to engage in interstate commerce. Many specifics of how this interstate commerce will operate are left to the rulemaking process, but it should generally be anticipated that consumers will gain access to marijuana products created in other states.

- **What would the tax rate be under the States Reform Act?**

Section 5901 establishes a new federal excise tax on marijuana products at a rate of 3 percent of the products' value. This would be assessed at the point of wholesale transfer between a producer and another producer, distributor or direct customer. The excise tax must be based on the fair value of the underlying products in an arms' length transaction, which the Treasury Secretary will gain the ability to determine through rule. Effectively, this may mean the Treasury Department will determine a prevailing market price per unit of weight for various products based on periodic surveys. Several states, including Colorado and Nevada, follow a similar approach for the administration of marijuana excise taxes.

- **How difficult would it be to get a federal license to produce marijuana under the States Reform Act?**

Section 302 clarifies that the TTB "shall issue" a federal license to operate a marijuana business to any applicant that is not specifically excluded by a narrow range of criteria. These criteria include: (1) the likelihood that that applicant will never commence operations based on lack of business experience, financial standing or trade connections; (2) any proposal to operate in a state where marijuana is not legal; (3) a fraudulent misrepresentation of information within the application; or (4) the applicant has been convicted of a felony offense relating to marijuana within three years prior to application or a misdemeanor offense within one year of application

unless the underlying action was lawful under state law. This “shall issue” standard makes approval the agency’s default decision for licensing applications unless the agency can prove one of the disqualifying criteria is relevant to a particular case.

Section 302 further clarifies that all existing state-licensed marijuana businesses in good standing shall be issued a federal license through the TTB upon application. This grandfathering provision will ensure continuity of operations and growth opportunities for existing state-licensed marijuana businesses.

The Secretary of the Treasury will be able to charge licensing fees sufficient to cover the cost of the Department’s regulation through the TTB. These amounts will be determined by rule but are restricted within the first three years of the agency’s regulation to no more than \$10,000. In addition, the Department must waive these licensing fees for any applicant that meets the Small Business Administration’s definitions for a small business or a socially or economically disadvantaged business.

- **Does the States Reform Act do anything specific to protect veterans’ access to marijuana?**

The States Reform Act contains several provisions of particular concern to veterans of the armed forces. Section 601 precludes any federal agency from denying employment to a veteran based solely on the reason that the veteran consumes or has consumed marijuana. Section 602 expressly allows doctors within the Department of Veterans Affairs to recommend marijuana products to patients who may benefit from the use of these products.

- **If marijuana is legalized federally, what would happen to people who have been convicted of federal marijuana crimes in the past?**

Section 101 requires all Federal districts to expunge the records of practically all nonviolent federal marijuana arrests or convictions within one year of passage. This would be accomplished without the need for individuals to retain legal counsel or submit an application to remove the record of their specific offenses. Instead, all qualifying records would be automatically expunged. The bill provides for only a limited range of exceptions, such as for individuals who are or have been associated with foreign drug cartels or who were convicted of driving under the influence of marijuana on federal property.

- **How would the States Reform Act empower previous victims of the war on drugs?**

Various provisions of the States Reform Act would combine to create pathways of restorative justice for victims of the war on drugs. First, all nonviolent criminal records would be expunged for these individuals, removing significant barriers for these individuals to engage in healthy and productive behaviors like attending college, applying for a home or business loan, or securing lucrative employment. Further, these individuals would even gain the ability to pursue a license to operate federally licensed, legal marijuana businesses to make productive use of their knowledge of the marijuana market. Finally, many of these individuals may even be able to qualify for assistance in launching a new marijuana business through a Small Business Administration loan and through a waiver of licensing fees.



An Encouraging Development for the Cause of Cannabis Legalization

By Jeffrey A. Singer, Senior Fellow, November 16, 2021

Yesterday, U.S. Representative Nancy Mace (R-S.C.) introduced the States Reform Act that would remove cannabis from the federal government's list of controlled substances, expunge federal criminal records related to nonviolent cannabis offenses, prevent the Small Business Administration from discriminating against state-licensed cannabis businesses, and allow doctors practicing in the Veterans Affairs Health System to prescribe medicinal marijuana.

In those respects, the proposed legislation has much in common with a bill introduced in the U.S. Senate by Majority Leader Chuck Schumer (D-NY) over the summer, and the Marijuana Opportunity Reinvestment and Expungement (M.O.R.E.) Act that was passed by the House of Representatives in December 2020. The latter garnered only a few Republican votes.

However, this bill, drafted with input and model language from Geoffrey Lawrence of Reason Foundation, locks in place a 3 percent federal excise tax on marijuana for 10 years. In contrast, the Schumer proposal features a 10 percent excise tax that grows to 25 percent in 5 years. The M.O.R.E. Act starts with a 5 percent excise tax increases it to 8 percent over 5 years.

The Mace bill distributes the revenue to existing entities while Schumer's creates three new grant programs.

Another important distinction of Mace's bill is that it grants the Food and Drug Administration the authority to regulate cannabis in the same way it regulates alcohol and "no more." Therefore, the FDA may regulate labeling, prescribe serving sizes, and approve new drugs or medical uses derived from cannabis, but it "may not prohibit the use of cannabis or its derivatives in non-drug applications."

In common with the two previous proposals, the bill defers to the individual states the right to determine the legal status of cannabis.

The regulatory features of the bill are simpler and sparser than the other two proposals. Thus the bill will hopefully gain more Republican support. Here is the "one-pager" of Rep. Mace's bill.

Rep. Mace has drawn a "scathing rebuke" from the Chairman of the South Carolina Republican Party, Drew McKissick, who stated:

Our Party platform is clear: "We support firm enforcement of existing laws against the abuse and distribution of controlled substances, and we oppose any effort to legalize the use of controlled substances," and that includes marijuana.

Of course, the proposed law would not force South Carolina to legalize cannabis.

Rep. Mace is showing leadership and courage by contributing to the noble effort of ending federal cannabis prohibition and respecting federalism despite pushback from her state's GOP leadership.



GOP Cannabis Legalization Bill Could Finally Surmount Partisan Divide

By Michelle Minton, Senior Fellow, November 22, 2021

Even with the majority of Americans having supported cannabis legalization for nearly a decade, proposals to decriminalize the substance at the federal level have been hobbled by partisan politics. However, last week, Rep. Nancy Mace (R-SC) introduced the States Reform Act (SRA), a “compromise bill” she hopes can bridge this partisan divide. Though some of her Republican colleagues may be reticent to endorse a bill that fully decriminalizes cannabis at the federal level, its biggest hurdle will be in gaining enough support from Democrats who view it as not going far enough. But Democrats shouldn’t be too quick to dismiss Rep. Mace’s proposal. While it certainly has room for improvement, it is a very good starting point for truly bipartisan legislation that could finally end America’s disastrous prohibition, once and for all, while also making significant strides toward rectifying the harms caused to disadvantaged groups by the War on Drugs.

For several years cannabis efforts in Congress have centered on two competing approaches.

On one side are GOP-backed bills, like the STATES Act, which would exempt state-authorized commercial cannabis activities from federal interference without taking further steps to address the disparities created by the War on Drugs.

On the other side are bills favored by Democrats, like the still-pending MORE Act, which would remove cannabis from the list of federally controlled substances (fully decriminalizing it at the federal level), expunge non-violent cannabis offenses, create a system of federal regulation, institute a federal excise tax, and earmark tax revenue for programs aimed at supporting disadvantaged individuals, businesses, and communities. Though there seems to be broad support for the social equity provisions of the MORE Act, the regulatory burden and high taxes it would impose have led even some staunch supporters of legalization to withhold support for the bill, leaving it stuck in a sort of limbo since being approved by the House.

Rep. Mace's bill attempts to split the difference between the two approaches. At just over 130 pages, the States Reform Act is the most comprehensive cannabis legislation ever introduced in Congress. Its length is due in part to the fact that, in addition to its own unique features, it also contains many of the equity provisions included in the MORE Act, sometimes verbatim. But it has key differences. Like the MORE Act, the SRA removes cannabis from the Controlled Substances Act's list of scheduled drugs, expunges non-violent offenses related to cannabis, and creates programs aimed at supporting small and disadvantaged cannabis businesses. It would also impose a federal tax, create systems of regulatory authority, and institute protections against discrimination for certain cannabis users and businesses.

Yet, Mace's bill diverges from the Democratic proposal in which agencies would have regulatory authority, the level of taxation, how tax revenue would be spent, and which individuals and businesses would be offered explicit protections. Those details which may prove the biggest challenge in gaining Democratic support for her bill.

Expungement. Both the MORE Act and the SRA expunge nonviolent cannabis-related offenses, but, unlike the MORE Act, Rep. Mace's bill does not limit offenses to those committed after 1971. It also includes an explicit directive for all federal authorities to cease enforcement actions against non-violent cannabis offenders and return property seized through civil asset forfeiture. However, it excludes "foreign cartel members" and offenses related to driving under the influence from expungement eligibility.

Protections. The MORE Act provides broad protections for cannabis users, including barring federal agencies from denying public benefits, employment, loans, or immigration services on the basis of cannabis use or non-violent cannabis offenses. The explicit protections listed in Rep. Mace's bill focus mainly on veterans who, for instance, had less-than-honorable discharges due to cannabis use upgraded to a "general" discharge, which would entitle them to certain benefits. But, while the SRA doesn't explicitly protect other groups and the MORE Act doesn't protect veterans, it is likely that both bills assume these protections are included in the more general provisions aimed at records expungement and non-discrimination. For example, Mace's bill does not—as the MORE Act does—prevent immigrants from being denied entry or services due to past use or non-violent convictions related to cannabis. However, because it applies its decriminalization of cannabis and records expungement to "every organ of the federal government," it is possible the bill implies these protections for migrants.

Regulatory Authority. Both the MORE Act and the SRA would set up systems for awarding permits to producers or importers of cannabis and for regulating labeling and marketing of cannabis products. The previous version of the MORE Act gave this responsibility to the Secretary of Health and Human Services. Although this isn't explicit in the current draft of the bill (an apparent textual error that only refers to "The Secretary" without clarifying which one), it seems the intent is the same—to give regulatory authority to Department of Health and Human Services (HHS) and to the already overextended Food and Drug Administration (FDA.) Mace's bill, on the other hand, takes a different and likely wiser approach to the federal role in regulating cannabis products.

The SRA seeks to treat cannabis like alcohol. To do this, it would deem cannabis as a "generally recognized as safe" additive, which would allow producers to use cannabis-derived ingredients in foods and beverages (an important change for edibles, hemp, and CBD products) without prior approval from the FDA. Furthermore, the proposal hands licensing and regulatory authority primarily to the Tax and Trade Bureau (TTB), the agency already in charge of administering federal laws and standards regarding the sale and marketing of alcoholic beverages. On this point, Mace's bill is the wiser approach.

Though not perfect, the Tax and Trade Bureau has proved capable of efficiently regulating the booze market, working with thousands of independent producers and regulating millions of individual products. For example, it typically takes the agency less than a month to approve new labels for alcoholic beverages. In other words, TTB has an established track record of working with large and diverse markets, which puts it in a good position to hit the ground running in overseeing what would be a multi-billion-dollar cannabis industry from day one. Such efficiency is highly unlikely at the FDA, which recently demonstrated its limited regulatory capacity by thoroughly bungling the e-cigarette approval process—which has taken two years and counting—and which now has the agency tangled in lawsuits.

Taxes/Fees. Perhaps the biggest sticking point with the MORE Act, especially for members of the industry, is its establishment of a large federal excise tax on cannabis products: 5 percent for the first three years and 8 percent thereafter. Piled on top of often sky-high state taxes, this steep federal levy would hamper the legal cannabis industry and continue to drive consumers to illicit sources, industry insiders claim. Mace's proposal would also tax cannabis at the federal level, but at a lower 3 percent, and keep that rate for at least 10 years to allow the legal industry to become established.

Spending. The other big point of contention will likely be how the revenue generated by the federal tax will be spent. The MORE Act earmarks 60 percent of the revenue for the Department of Justice (DOJ), with the rest going to the Small Business Administration (SBA) to carry out the bill's newly created Cannabis Restorative Opportunity Program and Equitable Licensing Grant Program. Mace's bill also diverts 40 percent of the revenue to DOJ, 30 percent to SBA for its Successful Second Chances" program to help disadvantaged and small cannabis businesses, 10 percent to the Department of Veterans Affairs for mental health services, and 10 percent to HHS for youth cannabis use prevention and state opioid-prevention grants.

Other differences. Mace's bill, unlike the MORE Act, would set a national minimum age for cannabis purchasing at 21. This would be enforced in the same way as the national minimum age for buying alcohol: by withholding federal transportation funds to states with a lower minimum age than the federal standard. However, Mace's proposal includes an exemption for states that allow minors to access medicinal cannabis for therapeutic purposes. The SRA bill would also grandfather in state medical cannabis products, allowing them to be sold in interstate commerce without prior federal approval. Mace's bill also provides a waiver of licensing fees for applicants who represent "a small business or a socially and economically disadvantaged business." The MORE Act has a similar provision, but it only applies to first-time applicants reporting an income of 250 percent below the poverty line for at least five of the last 10 years.

All told, there is a lot for MORE Act supporters to like about Mace's proposal, which, even if enacted in its current form, would set up the nascent cannabis industry for a good start and take significant steps toward Democrats' social justice and equity goals. But there is nothing preventing Democrats from attempting to make the SRA better (such as, by example, protecting more groups from discrimination and denial of federal benefits on the basis of cannabis use or offenses) by working with Mace's office or offering amendments. Such a bipartisan effort could result in a final bill that is more protective, corrective, and inclusive than either the MORE Act or the current version of the SRA—something that ought to appeal to members of Congress regardless of political affiliation.

Republican Congresswoman Introduces Bill to End Federal Marijuana Criminalization

Any legislation that takes us a step toward freedom is a welcome development.

By Brad Polumbo, Policy Correspondent, November 18, 2021

Dozens of states have legalized recreational or medical marijuana use, while a supermajority of the public supports ending its prohibition. Yet the federal government hasn't caught up, and marijuana remains technically illegal under federal law even in states that have outright legalized it.

A libertarian-leaning Republican congresswoman is leading the charge to correct this legislative dysfunction. South Carolina Rep. Nancy Mace recently introduced the States Reform Act, a bill that ends the federal prohibition and leaves it up to states to make their own call on marijuana legalization.

"Every state is different," Mace said. "Cannabis reform at the federal level must take all of this into account. And it's past time federal law codifies this reality. This is why I'm introducing the States Reform Act, a bill which seeks to remove cannabis from Schedule I in a manner consistent with the rights of states to determine what level of cannabis reform each state already has, or not."

The legislation is co-sponsored by five other congressional Republicans: Reps. Peter Meijer, Tom McClintock, Don Young, Kenneth Buck, and Brian Mast.

"While we've rightly designated states the authority to regulate marijuana, our federal policies still run counter to their efforts," Meijer told FEE. "States that have moved forward with marijuana decriminalization and legalization policies need clarity to continue their efforts, and our bill provides this certainty. I'm glad to partner in this endeavor to decriminalize marijuana at the federal level and give states clear cut control over cannabis laws and regulations."

The bill would end the federal prohibition of marijuana, require the automatic expungement of federal criminal records for those convicted of nonviolent marijuana offenses, and set a 3 percent excise tax on marijuana.

This tax is much lower than the 10 to 25 percent levied by Democratic legislation. And Mace's bill freezes the excise tax at 3 percent for 10 years—to stop the black market from lingering as has happened in states like California where marijuana is legalized but heavily regulated and taxed.

“The beauty of the States Reform Act is that it's both simple and reasonably comprehensive,” said Reason Foundation director of drug policy Geoffrey Lawrence, who helped craft the legislation. “Enacting major social change requires broad, bipartisan agreement, and the States Reform Act checks that box.”

Because the States Reform Act makes incremental, practical reforms, it could actually draw bipartisan support and pass a polarized Congress. If it does, it will make life much easier for legal cannabis businesses and users, who face many financial and legal headaches because their activity is still technically illegal under federal law.

We ultimately should live in an America where no peaceful individual activity like adult marijuana use is criminalized or outlawed. But progress takes time, and any legislation that takes us a step toward freedom is a welcome development in my book.

This article has been updated to include comment from Rep. Peter Meijer.



Republican Cannabis Bill Would Tax by Category

By Ulrik Boesen, Senior Policy Analyst, November 15, 2021

Today, Representative Nancy Mace (R-SC) released the States Reform Act, which would deschedule, regulate, and tax cannabis products with a novel federal excise tax design—based on quantities and predefined categories, not dissimilar from how the federal government taxes alcohol and tobacco. Rep. Mace’s bill would impose a tax of 3 percent on the removal price of cannabis products. That’s significantly lower than the rates suggested in the other bills introduced this year to deschedule and tax cannabis: the MORE Act (8 percent rate) and the Cannabis Administration and Opportunity Act (CAOA, 25 percent rate).

Arguably, the biggest impact on existing cannabis businesses would not be a new federal tax. Today, due to its Schedule I status, cannabis products cannot cross state borders, and as a result, all products must be grown, processed, sold, and consumed within state borders. Descheduling would create a national market where products grown in Oregon can be processed in Colorado and sold in New York. This would revolutionize markets in states, which, given the federal prohibition, are currently able to discriminate against interstate commerce. Descheduling would mean that state laws can no longer do so, as it would violate the Dormant Commerce Clause of the U.S. Constitution.

The bill is a discussion draft, similar to the CAO A in the Senate. While unlikely to pass in its current form, it is the first comprehensive cannabis bill introduced by a Republican in Congress, and it could pave the way for a future bipartisan effort to reform cannabis legislation.

Even if it is not the most important aspect of the bill, the tax design is still very important. Mace’s bill establishes six taxable categories and instructs that the Secretary of the Treasury can create more if needed. (The main risk with this design is the potential of an ever-increasing number of categories.) The tax would be levied at 3 percent of product category’s removal price (price when leaving the producer or a

bonded warehouse) during the prior federal fiscal year. The applicable removal price would be determined based on type of product:

- Cannabis flower (454 grams),
- cannabis pre-rolls (100 grams),
- cannabis extracts (20 grams),
- cannabis vape cartridges (10 grams),
- edibles (20 units), and
- topicals and cosmetic products (20 units).

Revenue would be allocated to the Law Enforcement and Second Chances Fund, which would fund community reinvestment, drug treatment, education, law enforcement, support for veterans, opioid addiction treatment, youth use prevention, and the Small Business Administration. The bill also establishes a 10-year moratorium on tax increases, which can only be waived by three-quarters vote in both houses of Congress.

This design turns the price-based (ad valorem) rate into a de facto quantity-based (specific) tax, since the levy would work by establishing an annual tax rate based on prices in the previous federal fiscal year, and taxpayers would calculate their liability on quantity. For four of the categories, the base is weight and for two the base likely would be potency. For example, if in fiscal year 2023 cannabis flower's removal price is \$50 per pound (454 grams), cannabis businesses would pay \$1.50 per pound of flower in taxes the following year. While it is not ideal to rely on prices to set the rate, it is highly encouraging that liability would be based on quantity. We have written extensively on the need to design cannabis taxes based on weight and potency, since those are superior proxies for negative externalities.

The creation of categories avoids some of the biggest issues with price-based taxation, as it guarantees that comparable products are taxed at the same rate regardless of price. Under a pure price-based tax design, an expensive THC-containing chocolate bar would be taxed at a higher rate than a cheap THC-containing chocolate bar—even if they contain the exact same amount and quality of THC. (Tetrahydrocannabinol is the main psychoactive compound and is generally used to define potency of the marijuana product, even though there are other compounds in the plant which may influence the effects on the user.) Taxing the value of the product is not an excise tax's job—capturing value should be left to sales and income taxes.

Rep. Mace's design does not eliminate all issues, however. Treasury will still need to establish a tax rate each year based on the prior year's removal price. That is far from a simple task and could easily develop into an administrative headache. Many products may move through vertically integrated value chains, meaning that no arms-length transaction's removal price would exist. Establishing value when no transaction has taken place is problematic and issues surrounding transfer-pricing are often debated in tax policy. Relying on price also harms the stability of the revenue. Interstate commerce is all but certain to result in substantial price declines and having a rate that follows those prices would negatively impact revenue generation. Both issues could be resolved by setting a fixed rate per category similar to how almost all other federal excise taxes are designed.

In addition to impacting prices, interstate commerce will make tax collection more complicated for all states, but several states could be uniquely exposed to the effects of federal reform. For instance, some states levy taxes on cultivators without offering exemptions for products exported, and under a federal framework that allows interstate sales, those taxes could hurt the states' competitiveness by increasing costs for in-state cultivators. For the majority of states that apply ad valorem taxes at retail level, a federal ad valorem tax imposed before retail would compound and result in tax pyramiding; the federal tax would be embedded in the sales price taxed by the state.

An often overlooked part of excise taxation is tax definitions. The States Reform Act applies a very narrow definition of cannabis, which may create loopholes and inequities. Under the definition in the bill, which exempts hemp, only products containing delta-9 THC would be taxed. The issue is that delta-8 THC, also an intoxicant, can be extracted from hemp. It may be appropriate to change the definition of hemp to ensure that all THC is taxed equally.

The main tax complexity introduced by the bill, however, relates to a tax exemption for medical cannabis. While medical products arguably should not be taxed when the purpose of the tax is to internalize negative externalities, there is no uniform regulatory framework for what constitutes medical cannabis in the states. Normally, the Food and Drug Administration (FDA) determines what constitutes a medical product through its three-phase application process. The States Reform Act grandfathers existing businesses and products into the new federal system, which would grant a massive competitive advantage over recreational products to those given a medical designation in any state and override other states' more restrictive designations. New products coming to market would be subject to FDA review.

Excise taxes are not the only taxes cannabis businesses and consumers pay, and federal descheduling of cannabis would have a profound impact on income tax treatment of cannabis businesses as well. Existing businesses would benefit from descheduling by no longer being subject to Section 280E of the Internal Revenue Code, enacted in 1982 to deny the deduction of business expenses to those selling drugs on Schedules I and II of the Controlled Substances Act. While intended to stop illicit sellers from deducting expenses like guns and yachts used in smuggling operations, the IRS applies it to state-authorized marijuana retailers, which hurts taxpayers trying to comply with the law and creates a competitive advantage for the illicit operators that Section 280E was enacted to penalize.

This particular section of the tax code limits the deductions businesses can take when calculating their income tax liability. Traditional businesses can deduct ordinary expenses such as rent, marketing, utility costs, and payroll, but marijuana businesses are limited to deducting cost of goods sold (COGS). Cultivators have had an easier time than retailers as more expenses are directly associated with COGS. The unfavorable treatment of state-legal businesses has resulted in retailers selling marijuana experiencing effective tax rates well above 70 percent.

Levying a federal excise tax on recreational cannabis to internalize externalities associated with consumption can be legitimate if the tax is well designed. Designing such a tax will require careful considerations of trade-offs.

Unlike other widely used consumer products, cannabis use has been practically prohibited for almost a century (since the Marihuana Tax Act of 1937)—yet there are millions of users in the country today. Moreover, the federal government is late to the game. Eighteen states have already passed legislation to issue licenses and tax cannabis sales. High federal taxes risk creating problems in states that already levy high taxes on cannabis businesses and consumers. The success of the reform depends on competitive and, importantly, readily available alternatives to illicit products.

Rep. Mace's bill acknowledges this challenge by proposing a low tax rate. Combined with a sensible category design, the States Reform Act offers a promising way forward for recreational cannabis taxation.



R Street applauds introduction of GOP cannabis decriminalization bill

By Caroline Kitchens, Director of Government Affairs, November 15, 2021

WASHINGTON (Nov. 15, 2021)—The R Street Institute applauds Congresswoman Nancy Mace (R-S.C.) for her introduction of the States Reform Act. Cosponsored by Reps. Brian Mast (R-Fla.), Don Young (R-Alaska), Tom McClintock (R-Calif.) and Peter Meijer (R-Mich.), the States Reform Act is the most comprehensive framework for the decriminalization of cannabis at the federal level introduced by congressional Republicans to date.

Currently, 36 states including the District of Columbia have legalized some form of recreational or medical cannabis use, but it remains illegal under federal law. The States Reform Act remedies this untenable situation by deferring to state powers over prohibition and commercial regulation. It also includes critical criminal justice reform provisions that would expunge federal cannabis convictions for non-violent offenders who have no relation to a foreign drug cartel and provides opportunities for reentry.

Jillian Snider, Policy Director for R Street’s Criminal Justice & Civil Liberties program and retired New York City police officer, said “Decriminalizing cannabis is the right thing to do from a public safety standpoint. It will allow law enforcement to shift their focus toward violent crime and prolific offenders instead of investing undue time and scarce resources into low-level offenses like cannabis possession, which has historically produced racial disparities. It will also reduce the number of police-citizen encounters and increase police legitimacy.”

“The introduction of the States Reform Act is a critical moment in the national debate over cannabis,” added Caroline Kitchens, R Street Institute Director of Government Affairs. “A Republican-led proposal that focuses on developing healthy and competitive legal markets with reasonable levels of taxation is a welcome addition to the conversation. We applaud the growing bipartisan momentum surrounding decriminalization and thank Congresswoman Mace for her leadership.”

States Reform Act is Ideal Cannabis-Reform Legislation and a Win for Taxpayers and Consumers

By Taxpayers Protection Alliance, December 8, 2021; For Immediate Release; Contact: Lindsey Stroud (757-354-8170)

Washington, D.C. – The Taxpayers Protection Alliance (TPA) welcomes federal cannabis reform legislation recently introduced by Congresswoman Nancy Mace (R-S.C.). The States Reform Act is a comprehensive federal bill that would remove cannabis and other cannabinoids from the federal Controlled Substances Act.

The legislation would also expunge federal records for persons convicted of cannabis-related offenses within one year of the legislation’s enactment. Under the provisions, cannabis products would be regulated by the Alcohol and Tobacco Tax Trade Bureau and the legislation would specifically bar the U.S. Food and Drug Administration from regulating any non-medical cannabis product. Further, the States Reform Act would allow financial institutions to provide financial services to legal cannabis product producers. Finally, the legislation would impose a federal tax rate at three percent.

Lindsey Stroud, Director of the Consumer Center at TPA offered the following comments:

“As of September 2021, 47 states have legalized adult use of cannabis in some form, from cannabidiol (CBD) and hemp products to recreational adult use of cannabis products containing tetrahydrocannabinol (THC). In fact, in 2021, every single state cannabis-reform ballot measure passed. An April 2021 poll conducted by the Pew Research Center found that less than 10 percent of American adults opposed medical or recreational use of cannabis products. Despite this, the federal government continues to regulate cannabis as a Schedule I drug under the Federal Controlled Substance Act, which finds that there is no medicinal value to cannabis.

“The States Reform Act not only recognizes Americans’ approval of cannabis use for adults but will empower existing cannabis laws in the states. Currently, 18 states permit recreational cannabis use for adults, yet legitimate business cannot access federally-

regulated financial institutions because of the federal drug classification. This legislation corrects that.

“Unlike other federal cannabis reform legislation, the States Reform Act recognizes that punitive taxation would simply preserve existing black markets for cannabis products. The States Reform Act imposes only a low, three percent excise tax on cannabis products, which will be distributed to small businesses, law enforcement and mental health programs, and all-but shutter the \$70 billion underground market.”

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Taxpayers Protection Alliance (TPA) is a non-profit, non-partisan organization dedicated to educating the public through the research, analysis and dissemination of information on the government's effects on the economy.



Cannabis Industry Stakeholders, Policymakers Share Perspectives on States Reform Act By Yaël Ossowski, November 29, 2021

U.S. Rep. Nancy Mace unveiled the legislation Nov. 15 to allow state governments to regulate cannabis products through the health-and-safety oversights of their choosing.

During a Nov. 15 press conference, U.S. Rep. Nancy Mace, a Republican from South Carolina who took office at the beginning of the year, unveiled the States Reform Act (SRA), legislation that would allow state governments to regulate cannabis products through the health-and-safety oversights of their choosing.

The 131-page [draft bill](#) proposes a 3% federal cannabis excise tax, with a 10-year moratorium on excise tax increases to maintain a competitive marketplace.

The Alcohol and Tobacco Tax and Trade Bureau (TTB), which operates under the U.S. Department of the Treasury, would federally regulate the interstate commerce of cannabis products, while the Food and Drug Administration (FDA) would oversee medical cannabis.

The legislation also includes expungement provisions, but cartel members, agents of cartel gangs or those convicted of driving under the influence would be excluded from seeking expungement.

The Consumer Choice Center applauds Rep. Mace's effort to provide Americans with a smart, safe and consumer-friendly path to legal cannabis. A focus on establishing legal and safe markets will benefit all of society by finally eliminating the black market, restoring justice and giving the incentive for creative entrepreneurs to enter the marketplace. It is past time America had smart cannabis policies." – Yaël Ossowski, Deputy Director, [Consumer Choice Center](#)



What is the purpose of the States Reform Act?

By Jeremiah Mosteller, November 19, 2021

Earlier this week [media outlets](#) across the country covered the introduction of the [States Reform Act](#).

Americans for Prosperity [announced](#) that it would be supporting the bill and [noted](#) that it was “the first comprehensive, Republican-led legislation to end the federal prohibition on cannabis.”

Why was this bill introduction so important? What problem are these members of Congress attempting to solve?

A failed approach to marijuana policy

[Federal laws](#) regulating cannabis were adopted more than 50 years ago. They still reflect the [outdated perspective](#) that this plant “has no currently accepted medical treatment use” and is extremely dangerous to consume.

This perspective has resulted in our federal and state governments spending [trillions](#) in taxpayer money to catch and punish millions of Americans for the use and sale of cannabis.

The [number of annual arrests](#) related to cannabis skyrocketed by more than 320 percent between 1970 and its peak in 2009.

In total, law enforcement agencies have arrested more than [17 million Americans](#) for cannabis offenses since 1985.

These law enforcement activities have disproportionately affected communities of color even though rates of drug use are [similar](#) across all communities.

What have been the outcomes of this investment of trillions in taxpayer money?

- [Trends in marijuana](#) use show no consistent response to these enforcement efforts and the prevalence of cannabis use has increased among many age groups compared with the 1970s.
- Law enforcement agencies have shifted more and more resources away from their core mission of solving and preventing property and violent crime and toward drug enforcement efforts. Police now arrest someone as a suspect in a [historically low](#) percentage of [violent](#) (42 percent) and [property](#) (14 percent) crimes – leaving too many victims without justice and jeopardizing public safety.
- The black market for cannabis has continued to thrive and is only [beginning to erode](#) because of competition from the expanding legal market.

Bottom-up solutions

After decades of trying the same tactics without different results, some state leaders began to question whether their states were taking the right approach to cannabis policy.

The volume of these questions was elevated by a [growing body](#) of [research](#) revealing that marijuana can be an [effective treatment](#) for [certain medical conditions](#) and an admission from experts that it lacks some of the dangers associated with other drugs, such as [fatal overdoses](#).

Most states have now at least implicitly recognized the failures of prohibition and the potential promise of marijuana as an innovative medical treatment by allowing their citizens access to certain products. They have attempted to do so in ways that better control product quality and access among children.

Today, [18 states](#) allow adults to use marijuana and [36 states](#) have a medical marijuana program. Recent reforms occurred in states as diverse as [Alabama](#), [Connecticut](#), [Montana](#), [New Mexico](#), and [Virginia](#).

Federal control without teeth

The federal government seems to have reached the same conclusion in practice even if cannabis continues to be located on Schedule 1 of the Controlled Substances Act.

Congress has adopted an amendment each year since [2014](#) that prohibits the Department of Justice from using taxpayer money in ways that would prevent states from implementing medical marijuana programs.

The [past two](#) presidential administrations have also chosen not to enforce federal laws in states that have adopted reforms. This can be seen in the consistent year-over-year decline in the number of federal criminal cases involving marijuana in the past decade – now 20 percent of what they were in [2011](#).

The status quo leaves patients, doctors, entrepreneurs, and law enforcement with significant uncertainty.

The Controlled Substances Act is still the law of the land according to the Supreme Court's ruling in [Gonzales v. Raich](#) and the Constitution's [Supremacy Clause](#).

The principles of federalism mean that someone can be following every single regulation and guideline under state law but still be taking a chance they could be prosecuted and incarcerated under federal law.

This situation undermines both the credibility of federal law and the rule of law itself. It is difficult for citizens to respect our laws if they are not consistently enforced.

Inconsistent and arbitrary enforcement of a failed law is not a permanent solution.

The States Reform Act will restore state autonomy

As Justice Thomas recently [stated](#) the federal government's "half-in, half-out regime...strains basic principles of federalism."

The States Reform Act will finally end this confusing circumstance and restore the proper balance of power between states and the federal government.

As I recently [discussed](#), the States Reform Act would:

- Decriminalize cannabis at the federal level without forcing or incentivizing any state to change its laws.
- Establish a federal regulatory and tax structure that is pro-competitive and defers to current state market regulations.

- Protect military veterans by ensuring they will not be discriminated against in federal hiring or lose their VA health care benefits.
- Safeguard children and teenagers from cannabis products and targeted advertising.
- Provide retroactive sentencing relief and expungement for individuals convicted of crimes that will no longer be criminal under federal law.

How to get involved

Americans for Prosperity exists to elevate the voices of grassroots activists who seek to tackle our country's biggest challenges.

[Recent polling](#) reveals that an overwhelming majority of Americans support the long-overdue restoration of state autonomy in this area. As my colleague, Brent Gardner, recently [noted](#):

"It is time for members of Congress to catch up with their constituents who support the end of marijuana prohibition."

Our team seeks to empower every one of these Americans to have their voices heard on this important issue and [tell Congress](#) to support the State Reform Act.

Want to join us? Get involved [today](#).

Finally, these additional resources will deepen your understanding of the States Reform Act:

- [AFP applauds republican house members for introduction of states reform act](#)
- [Why Americans for Prosperity supports the States Reform Act](#)
- [Cannabis Freedom Alliance endorses Rep. Mace's States Reform Act](#)
- [Representative Nancy Mace introduces bill to end federal cannabis prohibition](#)
- [Protect public safety: a better approach on marijuana](#)



 AMERICANS FOR PROSPERITY

States Reform Act is the Only Federal Cannabis Legislation That Can Compete with Black Market

By Lindsey Stroud, December 21, 2021

Some have said 2020 was the [year for cannabis reform](#). Fortunately, the momentum has carried through 2021 and looks to continue in 2022. Congress has paid attention and there are multiple federal proposals from both sides of the political aisle that would remove cannabis from the federal Controlled Substances Act, which currently classifies cannabis as a Schedule I drug. This is the most restrictive classification and is defined as having a high potential for abuse and no medicinal value.

Three federal bills at the moment offer comprehensive cannabis reform. In addition to removing cannabis from federal drug scheduling, the proposals would implement regulations on manufacturing and sales, as well as enable financial institutions to provide services to legitimate cannabis businesses. Further, each proposal would impose a federal excise tax, to varying degrees.

Currently, the reintroduced [Marijuana Opportunity Reinvestment and Expungement](#) (MORE) Act from Rep. Jerry Nadler (D-N.Y.) would impose a five percent tax on retail cannabis sales that would increase to eight percent after three years. Sens. Chuck Schumer (D-N.Y.), Cory Booker (D-N.J.), and Ron Wyden (D-Oreg.) have unveiled a “discussion draft” of the [Cannabis Administration and Opportunity Act](#) which would impose a 10 percent tax on cannabis products which would increase to 25 percent over five years. Finally, Rep. Nancy Mace (R-S.C.) has recently introduced the [States Reform Act](#) that would impose a three percent tax rate that would remain unchanged.

Federal legislation is long overdue. As of September, 47 states have legalized some form of cannabis – from cannabidiol (CBD) and hemp to recreational adult cannabis use. As mentioned, 2020 was a big year for cannabis. Two states (Illinois and Vermont) legalized sales through their state legislatures and every single cannabis reform measure during the November 2020 election passed, including measures in Arizona, Montana, New Jersey, and South Dakota, all of which legalized recreational marijuana.

How the federal government regulates and taxes cannabis products will equally impact states regardless of their state cannabis laws. Arguably, the tax imposed at the federal level may be more important than the regulations themselves.

States and the federal government are attempting to introduce legal, regulated products where a thriving black market for these products already exists. In 2019, it was estimated there was [\\$70 billion in illegal cannabis sales](#) in the U.S. In order to effectively compete, governments must impose competitive tax rates – if they're to impose a tax at all.

The adverse effects of high taxes can already be seen in states with recreational marijuana sales. States such as California and Illinois impose steep taxes on recreational marijuana. It's estimated that in [California](#), the illegal market is worth \$8 billion annually, which is "twice the volume of legal sales." In Illinois, [prices](#) for legal cannabis products are "higher than every other state." Due to the costs, the illegal market is said to be over \$4 billion and still lucrative to drug dealers. According to one [marijuana dealer that was operating in Chicago](#), they were able to raise their own prices after the Prairie State legalized recreational sales.

Competing with the black market could not come at a more opportune time for both states and the federal government. Prior to the ongoing COVID-19 pandemic, the United States was hit with a spat of vaping-related lung injuries that were overwhelmingly caused by black market vapor products containing tetrahydrocannabinol (THC) – the psychoactive ingredient in marijuana.

In December 2019, the [Centers for Disease Control and Prevention](#) found that among patients diagnosed with a vaping-related lung injury, 80 percent reported using THC-containing vapor products. Of those using THC vapes, over half (56 percent) had indicated they had used the product brand "Dank Vapes." Even before the lung injury spat, Dank Vapes products were associated with adverse effects. In July 2019, a [Wisconsin man was hospitalized](#) after using a Dank Vapes product containing THC. Federal proposals to regulate cannabis can help deter the use of black-market products including Dank Vapes.

Federal cannabis regulation is long overdue as states navigate through a myriad of local cannabis laws. But federal legislation must take into account the existing market and be competitive. Any federal proposal must not overtax cannabis in order to effectively compete and dominate the future U.S. cannabis market.

Lindsey Stroud is Director of The Taxpayers Protection Alliance's Consumer Center. She wrote this for [InsideSources.com](https://www.insidesources.com).