webjoint

# 280E:

## UNDERSTANDING AND OVERCOMING TAX DEDUCTION FORBIDDANCE FOR CANNABIS DELIVERIES

**What is 280E and how does it affect Cannabis Deliveries?
Can cannabis retailers really not deduct expenses?
The WebJoint Team answers these questions and more in this resource guide.**

**DISCLAIMER**

The content in this resource guide is a compilation of information and strategies collected through various individuals in our industry. It is not meant to act as legal advice. Consult with your CPA and legal counsel for more information.

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

**–IRS MEMORANDUM**

# IMPLICATIONS

In simple terms, cannabis businesses are only allowed to deduct expenses that are part of the "costs of goods sold." Though one could argue that cannabis deliveries have a cost to selling their goods (i.e. purchasing delivery vehicles or building an eCommerce shop), neither of those expenses are tax-deductible. It's weird, we know. The following is a list of items that are considered costs of goods sold under IRS Regulation 1.47-11(c)

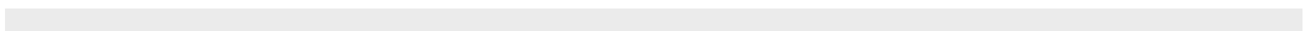
- **Ongoing maintanence of machinery and equipment**
- **Labor costs and employee benefits**
- **Insurance costs**
- **Supplies**
- **Utility costs**
- **Property and sales tax**

It seems that most of the costs of goods sold are taken on by cultivators. So where exactly does that leave retailers? The following is a list of expenses that are not tax-deductible.

- **Marketing and sales expenses**
- **Advertising**
- **State income taxes**
- **General administrative costs not directly tied to the production of goods**
- **Transportation from the company**

We spoke to Cannabis CPA, Sonia Luna, in our series "Connecting Cannabis." In our discussion regarding 280E, she stated:

***The way the federal government sees it (costs of goods sold): "You bought it, that's a final packaged good that's been tested and proven to be able to enter into the market place. That's it."***



## Where does this leave deliveries?

Cannabis retailers suffer large losses considering they spend a significant amount of money on marketing and advertising. In addition, main operational costs like purchasing vehicles, are unable be deducted. Only depreciation and maintenance of machinery count as valid deductions— unlike the actual purchase of the vehicles. In some scenarios, that can be an expense of over $100K that contribute to a delivery's effective tax rate.

Luna also touches on the federal effective tax rate for cultivators vs. cannabis deliveries:

> ***Cannabis delivery companies have had the worst end of that 'federal effective tax rate'. Their tax rate is between 45% and 65% and you look at the farmer, and he's in between 25% and 35%. It's very disproportionate.***

*"Delivery providers should work with their accountant to identify inventory control procedures and identify any activities that maybe allocated to cost of goods sold under IRS rules. It's a slippery slope so getting your CPA to guide you in this area is critical."*

-Sonia Luna

1. Isolate any cannabis activities to one company. Have the owners of the company set up an affiliate that does not touch any cannabis product. Most importantly, have that business provide property and services needed by your cannabis business at a reasonable markup.

List of possible services:

1. Renting and repair of machinery/equipment
2. Renting facilities
3. Insurance
4. Utilities
5. Furnishing materials

2. Have a separate entity handle any non-cannabis related activities/sales as to not consider their activities as "trafficking" of any schedule 1 substance.

3. Establish an LLC. Owners can deduct 20% of their income under section 199A.

These three options are merely band-aid solutions that aim to fix a larger problem: the tax code itself. Pushing for legislative change is the correct way to go about lowering tax rates. These options may temporarily allow you to cut your losses but always confirm with a CPA and legal counsel before taking any action.

# IT DOESN'T END WITH 280E.

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