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Cannabis: THC vs. CBD Critical Differences

(<https://cpatrendlines.com/?p=68388>) How they are different and what accountants need to know.

By Andrew Hunzicker

CPA Trendlines Cannabis (<https://cpatrendlines.com/category/cannabis/>).

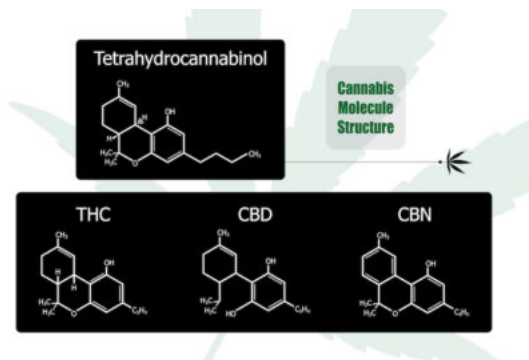
When you look at a cannabis plant and a hemp plant side by side, the plants themselves look identical to an untrained eye, making it a bit challenging to identify, as the real difference lies in the chemistry of the plants.

But to the accountant, the differences are critical.

See more from CPA Trendlines CannaBizCPA.Pro here (<https://cpatrendlines.com/category/cannabis/>).

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Get Hunzicker's FREE download: "How to Find and Connect with Cannabis CEOs in 5 Steps (https://checklist_download_cannabis_ceos.gr8.com/)"



Issues include clients in many verticals – cultivation, chemical manufacture, product manufacturing, labs, and retail – cost accounting, consolidations, and multi-entity issues, banking, software, and cash management, to name just a few.

And the tax and compliance issues are actually more complex for Hemp/CBD products than for cannabis products.

How are the two plants different?

CBD can be extracted from hemp or marijuana. Hemp plants are cannabis plants that contain less than 0.3 percent THC (the compound that creates the “high” sensation), while marijuana plants are cannabis plants that contain higher concentrations of THC.

So basically, the only difference from a scientific standpoint is the level of one chemical.

Differences from a legal perspective:

However, things are much more complex from a legal perspective. Under the 2018 Farm Bill, CBD and Hemp are now legal, and not on the Schedule 1 list of controlled substances. Marijuana and anything containing more than 0.3% of THC are still illegal, listed on Schedule 1 and subject to federal tax code 280e which is very punitive on the cannabis industry. Even though cannabis is federally illegal, it is legal in 33 states, either medically or recreationally, adding to the complexity of the industry.

Let's dive into 280E

280e is a very short part of the tax code (just one sentence) and states:

"No deduction or credit shall be allowed for any amount paid or incurred (<https://www.law.cornell.edu/uscode/text/26/280E>), during the taxable year (<https://www.law.cornell.edu/uscode/text/26/280E>) in carrying on any trade or business (<https://www.law.cornell.edu/uscode/text/26/280E>), if such trade or business (<https://www.law.cornell.edu/uscode/text/26/280E>) (or the activities which comprise such trade or business (<https://www.law.cornell.edu/uscode/text/26/280E>)) consists of trafficking in controlled substances (within the meaning of schedule I and (<https://www.law.cornell.edu/uscode/text/26/280E>)) II of the Controlled Substances Act (https://www.law.cornell.edu/topn/controlled_substances_act)) which is prohibited by Federal law or the law of any State (<https://www.law.cornell.edu/uscode/text/26/280E>) in which such trade or business (<https://www.law.cornell.edu/uscode/text/26/280E>) is conducted"

Under 280E, you're not allowed any deductions or credits on your return, but you CAN deduct the cost of goods sold as that is part of the definition of taxable income, and not a deduction or credit. 280e will only affect cannabis entities.

A cannabis farm will only be allowed to allocate various costs, direct and indirect, into COGS and Inventory using section 471-11. This is available to a Hemp farm as well, however for hemp and CBD companies, since they are legal, are allowed all normal business deductions and credits available to other non-cannabis companies. Additionally, for inventory accounting, a hemp/CBD company has 263a, and farm accounting rules available as well. This provides many more opportunities to reduce taxable income to a hemp/CBD company.

One strategy for a cannabis farm to consider is having another entity that grows or sells hemp/CBD (as long as state rules allow) as a way to possibly share overhead and utilize deductions available the non-cannabis division. Any non-cannabis division (which can include CBD/Hemp) must be profitable, significant and accounted for separately.

CBD specific regulations and accounting considerations:

On the tax side for a CBD/Hemp company, it's actually more complex than cannabis as there are many issues to consider including IRC 471 (inventory) and IRC 263a (inventory), Farm accounting (below), and new 199a laws related to pass-thru entities. The tax issues are complex and there are no "answers" that will apply to all CEOs and investors but will depend on each individual and their current tax situation. So, the answer for some might be to file as a farm but for others, there might be a different solution. Your goal should be to understand the basic tax issues (unless you also file returns) and help your client consider all options with whoever prepares the returns (you or someone else).

For clients that use Farm Accounting, it does open up the option of cash basis of accounting:

Inventory Exception for Farming - not required to maintain an inventory if the average annual gross receipts for the 3 preceding tax years for the farm is \$25 million or less and farm is not a tax shelter. Farm can use a method of accounting that (1) treats inventory as non-incidental materials and supplies, or (2) accounts for the inventory in the same manner as the applicable financial statements.

Cash Basis Benefits include: usually defers taxes as revenues pushed out expenses moves, and much simpler to do taxes.

Disadvantages: Accounting is better for raising capital and its exits, valuation, and management reporting

OTHER REGULATIONS: LinkedIn Group (<https://www.linkedin.com/groups/115382>) Newsletter (ac.cpatrendlines.com/f/10)

CBD/Hemp is also subject to federal (https://federal.regn/cpas/trendlines) though ~~Subscribe to our YouTube Channel (https://www.youtube.com/channel/UCD344mpwacymtthet.com/like/cpatrendlines)~~ compliance issues. Also, be aware that the USDA and FDA are currently trying to implement the first round of regulations (target "fall 2019"/USDA has issued "temporary rules), so this is in flux and will be evolving over time.

USDA

The USDA oversees ALL Hemp production. Rules are being written now and will likely be changed regularly, so make sure you go to the USDA website and sign up for emails or check regularly.

FDA

FDA (Food & Drug Administration) will regulate the rules around CBD being put into foods, supplements, and beverages. There are issues around packaging/labeling, as well as *any* medical benefits on the package or adds.

EPA

The Environmental Protection Agency will also regulate Hemp farming and pesticides (see link below) and again, rules in flux, being created so get alerts or follow their site:

<https://www.epa.gov/newsreleases/epa-seeks-public-comment-pesticide-applications-hemp> (<https://www.epa.gov/newsreleases/epa-seeks-public-comment-pesticide-applications-hemp>).

EPA also oversees farming and is currently reviewing pesticide application for hemp crops

OSHA

OSHA regulates safety for farms, manufacturers, etc. Make sure to be somewhat aware of these rules as well:

<https://www.osha.gov/laws-regs/standardinterpretations/2007-07-16> (<https://www.osha.gov/laws-regs/standardinterpretations/2007-07-16>).

STATE REGULATIONS

Forty-six states have their own rules and licenses that hemp/CBD must also be in compliance with as well as counties, and cities. You won't be able to know all the rules in every state and most have nothing to do with accounting. That said, know your own state rules and just be aware that state rules exist and CEOs must comply with licensing and tax rules of their location.

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Posted on November 11, 2019

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Andrew Hunzicker, CPA, has been a CFO for 20 years, and in 2017 won CFO of the Year Award, runner-up in the State of Oregon – the first ever in the cannabis space.

Ancor Advisors, is a full-service accounting solution for companies in every area of the Industry (farms, labs, dispensaries, processors, manufacturers). Additionally, the company teaches accountants, CPAs, and bookkeepers all around the US how to launch and grow a cannabis accounting firm.

See www.dopecfo.com (<http://www.dopecfo.com/>) for more information.

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