
SECTION 280E AND THE MARIJUANA INDUSTRY

SMALL FIRM PRACTITIONERS CONFERENCE

LC SOLUTIONS MICHIGAN PLLC

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§280E

- “§280E” is well heard of in the marijuana industry
- Clients are aware, but generally misguided by their own research
- Non accountants have referenced the topic at marijuana business events, often with mis-interpreted claims of a ‘70%’ income tax rate and that \$0 costs are recoverable, adding to confusion



WHAT DOES §280E SAY?

- IRC § 280E: “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.”
- Marijuana is currently classified a schedule I controlled substance. Businesses producing or selling marijuana must follow §280E
- Further explanation following in Congress’s report states: “All deductions and credits for amounts paid or incurred in the illegal trafficking in drugs listed in the Controlled Substances Act are disallowed. To preclude possible challenges on constitutional grounds, the adjustment to gross receipts with respect to effective costs of goods sold is not affected by this provision of the bill.”
- Enacted in 1982 by Congress



HOW TO RESPOND

- SG&A expenses disallowed federally. Only COGS allowed.
- Know Client's Cost of Inventory in order to know Cost of Goods Sold
- §471 General rule for inventories – in place in 1982
 - Producers
 - Purchasers / Resellers



PRODUCERS: CULTIVATORS & PROCESSORS

- Section §1.471-3 Inventories at cost
- 1.471-3c “Producers” What is includible?
 - (1) The cost of raw materials and supplies entering into or consumed in connection with the product
 - (2) Expenditures for direct labor
 - (3) Indirect production costs incident to and necessary for the production of the particular article, including in such indirect production costs an appropriate portion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit
- Look to manufacturing, pharmaceutical or food industries
- Know your Client’s inventory terminology and uses



RESELLERS: PROVISIONING CENTERS

- Section §1.471-3 Inventories at cost
- 1.471-3b “Purchasers” What is includible?

“In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

- Harborside Heath Center November 2018 Tax Court Opinion

<https://www.ustaxcourt.gov/ustcinop/OpinionViewer.aspx?ID=11828>



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WHAT ABOUT §263A?

- Added in 1986, 4 years after §280E
- Amendment in 1988:
 - 263A(a)(2) “Any cost which could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph.”
- 2015 Memorandum: addressed 263A
<https://www.irs.gov/pub/irs-wd/201504011.pdf>
- Harborside 2018: reaffirms position



SECURE TRANSPORTERS?

- Statutorily required – Michigan was the first to enact a licensing model and require use of a secure marijuana transporter.
- Transports marijuana products and cash payments between marijuana facilities
- Application of §280E
 - Trafficking?
 - Cost of services performed?
 - Not applicable?
 - No deductions because no COGS?



SAFETY COMPLIANCE FACILITIES?

- Also statutorily required, but largely existed prior to MMFLA
- Tests marijuana products for contaminants and potency
- Application of §280E
 - Trafficking?
 - Cost of services performed?
 - Not applicable?
 - No deductions because no COGS?



OTHER CONSIDERATIONS

- Additional record keeping
 - Overhead allocations, calculation support
- Inventory reporting
- Customized COA
- Return preparation, federal vs state



DEVELOPMENTS

- Congress is talking about marijuana laws!

<https://judiciary.house.gov/legislation/hearings/marijuana-laws-america-racial-justice-and-need-reform>

- Increased pushback from businesses

- States continuing to move forward with their own regulations

- Resource: <https://www.thetaxadviser.com/issues/2018/aug/inventory-accounting-cannabis-businesses.html> (August 2018, before Harborside opinion)



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QUESTIONS?

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