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Craig Smalley • Nov. 22, 2017

For those of you that are in the cannabis industry or just starting out, you have no doubt either been hit with a large tax bill or you are about to be. However, it doesn't have to be that way. There are many steps that you can take legally just by working within the confines of the Internal Revenue Code.

To spare you the long and drawn out reasons why cannabis is taxed the way it is, I will summarize by going go back to 1982, when Congress passed IRC §280 E, which states:

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.

In light of the above information, and with the general lack of tax expertise in the cannabis industry, it is not uncommon for someone with a dispensary to be effectively paying ***70% in taxes***.

Notice that I am using the word cannabis and not marijuana. Marijuana is the flower or bud of the cannabis plant. Cannabis entails the entire plant and its derivatives, such as hemp, CBD oil, anything where the business owner effectively touches the cannabis plant.

But the important question is, how do we get around the tax constraints that all but suffocate the cannabis industry? First of all, you can deduct your cost of goods sold

(COGS), but that amount varies depending on what you do within the industry.

start a management company, preferably off-site, that can be used to dry the plant. The management company would store the crop until the grower sells it. The grower can then pay a fee to the management company for housing the plant. That would be added to your COGS. In addition, it is a way to pay an owner's salary, and other expenses that wouldn't normally be deductible. The management company would be a non-Section 280E company and could deduct all of the expenses that the grow can't.

DISPENSARIES

Dispensaries are a little harder than growers. For instance, COGS for a dispensary would be the money used to buy the cannabis. However, there are some things that we can do to increase those costs.

In my firm, when we are first engaged with a Cannabis Dispensary, we spend about four days in the dispensary doing a couple of things. First of all, we section off about 25% of the dispensary to hold inventory. The owner becomes the inventory manager. This allows for the owner's salary to be written off and 25% of the rent and utilities to be deducted as well.

Another option comes from a famous Tax Court Case called Californians Helping Alleviate Medical Problems (CHAMPS) v. Commissioner. What CHAMPS was doing was charging a membership fee. The fee included the cannabis as well as caregiving, such as counseling, yoga classes, and other alternative health options. The Tax Court ruled in favor of CHAMPS and allowed them to deduct other expenses, and they also determined that a cannabis business can run two different businesses under one roof.

So, do put something like what CHAMPS was using in place, we would first do a price analysis of the dispensaries within a 10-mile radius of the dispensary that has engaged us. We then come up with the lowest price and the highest price that cannabis is being sold for. Then, we split the dispensary in half. One side used as a

the cash register for minimum wage, and then make up for their salary in the caregiving facility.

Obviously, this wouldn't work for recreational marijuana, but you could still run another business selling paraphernalia and other things that compliment the cannabis sales.

It is common for a grower to sell to a dispensary at a lower price if they buy in bulk. The problem is most dispensaries don't have the room for the excess inventory. To alleviate this, we start a management company, similar to the grow, that houses the excess inventory. All inventory purchases are made by the inventory manager and paid for out of the dispensary, however the storage is done at the management company.

Just like the grow, the dispensary could pay a fee to the management company, which would be part of COGS. The management company could then deduct owner's salaries, benefits, etc.

Edibles are becoming popular, so the dispensary can also order trim from the grow, and work with a co-packing company to produce the edibles according to the dispensary's recipe. Then start another company that works like a branding company for edibles. Again, the branding company isn't a Sect 280E company, and can deduct all of its expenses.

Before you start doing this on your own without hiring a cannabis-versed tax accountant to set all it all up, you might want to reconsider. These businesses have to be set up correctly and the payments made to each company have to be done in a certain way.

What does all of this cost? A lot less than what the taxes paid would be. In every

sponsors.