The webinar will be starting soon...

CPA GREEN GROWTH

Taxes and the 280E: What are your responsibilities?

Derek Davis, CPA
Founder – GreenGrowth CPA

Agenda

- About GreenGrowth CPAs
- Business Structuring 101
- Nonprofit Mutual Benefit Organizations
- Cannabis Tax Responsibilities
- About the 280E
- What is COGS?
- What deductions can you claim?
- Penalties and Benefits
- Bookkeeping Best Practices

GreenGrowth CPAs

About Us:

- Certified Public Accountant – licensed in California since 2012
- Half a decade of Corporate Taxation at Deloitte Tax and PricewaterhouseCoopers LLP
- Testified on Capitol Hill regarding tax policy reform in November 2015
- Cited in numerous tax policies and tax form
- Involved in Cannabis Taxes since 2010

Business Structuring 101

- Nonprofit or Cooperative:
  - **Pros**: usually lower taxes or tax benefits; lower operational risk; cooperative structure ensures that the organization will be around even if you decide to move on.
  - **Cons**: lots of paperwork; additional compliance and regulatory demands; certain restrictions on campaigning and lobbying (among others);
- B-Corp:
  - **Pros**: it's a good marketing tool; your company may be more "economically resilient"; more attractive to potential investors; more attractive when hiring and retaining top talent
  - **Cons**: getting B corp certified is a tough process; B corps tend to face higher levels of scrutiny (internally and externally); shareholders tend to have more power than in normal C or S Corps.

Business Structuring 101

- C-Corp
  - **Pros**: lower risk of individual liability; attractive to investors; tax reform solves the double taxation issues, plus there are other tax incentives for forming a C Corp.
  - **Cons**: higher costs for state and federal filing fees; increased paperwork
- S-Corp
  - **Pros**: no double taxation; protection from personal liability; qualified business income deduction; can have up to 100 shareholders; easier accounting rules
  - **Cons**: there are many rules and fees; there are some shareholder restrictions; you are required to make a “reasonable salary,: even if your company is not making a profit.

Business Structuring 101

- Sole proprietorship:
  - **Pros**: simple to own and operate; you retain full ownership and decision-making; simple from a tax and accounting perspective; expenses are deductible from your income tax
  - **Cons**: high level of personal liability; hard to establish legitimacy when dealing with investors; difficult to run separate from the owner or founder
- General and Limited Partnerships
  - **Pros**: tax benefits for the partners; limited liability; no turnover issues; creates investment opportunities; clear roles for senior staff; less paperwork than a corporation
  - **Cons**: compliance challenges and risks are passed on to the general partners

Business Structuring 101

- LLCs and LLPs:
  - **Pros**: flexible management structure; limited personal liability; choice of tax options; fewer compliance issues; investment opportunities
  - **Cons**: incur "pass through taxation" and other special taxes in the state of California; less structure; taxation issues may discourage investors

Mutual Benefit Nonprofit Corporations

Defining characteristics:

- The assets of the corporation can only be distributed to members upon dissolution of the corporation, not during its operation.
- It can be established for any lawful purpose and is not limited to charitable or public purposes.

This structure is right for you if…

- Your organization wants to apply for exemption from federal and state income and/or franchise taxes under Sections 501(c)(6), 501(c)(7), 501(c)(8) or 501(c)(10) of the Internal Revenue Code and the equivalent section of a state revenue law.
- Your organization is not established for a charitable or public purposes but would benefit from the “nonprofit” brand.

Cannabis Tax Responsibilities

As a mutual benefit nonprofit corporation, you are still responsible for:

- Sales Tax
- Federal and State Income Tax
- State Corporation Fees
- Normal California cannabis taxes (paid quarterly)

Mutual Benefit Nonprofit Corporation - Dissolve or Convert?

1. Read the articles of incorporation to determine how it is formed
2. Looked at the fixed assets
   a. Depreciation
   b. Basis
   c. Potential tax liabilities
3. Often times easier to dissolve than convert

280-E TAX CODE

Ordinary Business		Cannabis Business	
Sales	$1,000,000	Sales	$1,000,000
Cost of Goods Sold	$400,000	Cost of Goods Sold	$400,000
Gross Profit	$600,000	Gross Profit	$600,000
SGA	$500,000	SGA	$0
Operating Profit	$100,000	Operating Profit	$600,000
Tax @ 35%	**$35,000**	**Tax @ 35%**	**$210,000**

280-E disallows Cannabis Touching Companies to deduct ordinary and necessary business expenses

The 280E and Taxes

- The 280E is a federal regulation that forbids deductions and tax credits for businesses involved in the illegal trafficking of drugs.
- Cannabis is still a Schedule 1 drug according to federal regulations.
- Therefore, California cannabis businesses are prevented from making normal small business deductions.

Local Cannabis Taxes - Specific

- Each city will regulate taxes in their own manor
- Research local regulations to see what your requirements are:
    - Based on square footage
    - Based on sales - absolute dollar amount
    - Percentage of sales

Sales and Use Tax

- Generally a fixed percentage
- Based on topline revenue
    - Make sure to charge it out!

COGS and allowable deductions

You can deduct:

- Products, packaging, and anything directly related to the sale of the cannabis product;
- The invoice price for cannabis, less trade or other discounts
- Electric bills for designated inventory areas (electricity used in sales areas are not eligible to be deducted as COGS)
- Transportation (the cost of travel to purchase cannabis, transportation and shipping costs of the cannabis)

You cannot deduct:

- Payroll
- Office supplies
- Anything not directly related to the cost of the product

Penalties...and benefits!

- The IRS tends to audit 10%-20% of licensed cannabis operators
- The Alterman Case demonstrates the worst-case scenario
- 90% of cannabis companies aren't doing any cost accounting throughout the year.

COGS Best Practices

- Create seperate account ledgers for COGS expenses and regular business expenses
- Set up a system of checks for verifying cash flow for each account ledger
- Practice strong inventory management and record keeping
- Set up controls to prevent fraud and theft
- Reconcile your ledger with your different account transactions daily, weekly, and monthly
- Keep a strong paper trail with receipts signed by vendors and pay slips signed by employees

Key Takeaways

1. Nonprofit mutual benefit corporations must still pay taxes
2. The 280E means you can only deduct the COGS
3. COGS is limited to certain specific business expenses
4. You are likely to be audited, so keep strong records and practice careful accounting.
5. When in doubt, consult a cannabis industry specific tax firm.

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Questions or need help with your business structuring?

Contact GreenGrowth CPAs today!

www.greengrowthcpas.com
(800) 674-9054