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IRS Allows Reduction of Gross Receipts For State-Legal Cannabis Businesses

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On Saturday, September 12, 2020, the Internal Revenue Service ("IRS") updated a marijuana industry frequently asked questions ("FAQ") page that provides relief to state-legal cannabis businesses. The FAQ announces that state-legal cannabis businesses can reduce their gross receipts by using an alternative accounting method under Section 471 of the Internal Revenue Code (the "Code").

The update comes following a Treasury Inspector General for Tax Administration report in which the agency estimated that it has failed to collect millions of dollars in unassessed taxes against state-licensed cannabis businesses that claimed improper business expense deductions under Section 280E of the Code. The report also calls for a coordinated, nationwide compliance plan to assist state-legal businesses in this regard.

Section 280E of the Code disallows businesses from claiming ordinary business expenses if the business activity consists of trafficking controlled substances which are classified as schedule I and II substances of the Controlled Substance Act. Historically, Section 280E was enacted in 1982 to prevent illegal traffickers from claiming tax deductions on their ill-gotten gains; however, the IRS has stated that it also applies to state-legal cannabis businesses as marijuana is a Schedule I substance.

While these state-legal cannabis businesses are prevented from claiming credits and deductions under Section 280E of the Code, the updated FAQ provides that Section 280E does not prevent participants in the marijuana industry from reducing their gross income by subtracting the cost of goods sold calculated pursuant to Section 471 from their gross receipts. Generally, Section 471 of the Code allows qualifying small businesses with less than $25 million in annual gross receipts to use an alternative accounting method where the gross receipts of the business are reduced by the cost of inventory and other expenditures, ultimately reducing the tax liability of a small business by a substantial amount.

The FAQ provides further guidance for those in the marijuana industry looking to comply with federal income tax reporting requirements, including state-legal cannabis businesses tax filing obligations, potential penalties and adjustments, and payment plans for those businesses who cannot fully pay their tax obligation.

If you have any questions, please contact R. Lance Boldrey (LBoldrey@dykema.com or 517-374-9162), Richard Lieberman (RLieberman@dykema.com or 312-627-2250), Scott Kocienski (SKocienski@dykema.com or 248-203-0868), Nardeen Dalli (NDalli@dykema.com or 248-203-0793), or your local Dykema relationship attorney.

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