



**ACCOUNTINGBUDS**  
LET US BE YOUR ACCOUNTING BUDS !

## **CEO & OWNERS GUIDE :**

UNDERSTANDING 280E &  
MANAGING YOUR CANNABIS ACCOUNTING  
DEPARTMENT



## **Rick LaNeve, CPA**

*Founder & CEO – Accounting Buds*



[rick@acctbuds.com](mailto:rick@acctbuds.com)



**201-442-9665**



### **Chairman**

Cannabis Committee of the  
NY State Society of CPAs



**Dope CFO**  
*VIP Pro*



## CANNABIS COMPANIES NEED TRAINED ACCOUNTANTS



*With razor-thin profit margins and all kinds of tax and capital issues to deal with, accounting operations for cannabis companies are more tricky than normal. Navigating through the laws, requirements, and technicalities can make or break your cannabis business if you aren't familiar with state and federal rules.*

*Inexperienced accounting professionals, who aren't familiar with the specific needs of cannabis companies, treat these businesses like every other company and are getting these business owners into hot water as a result of not knowing how to correctly do cannabis accounting. Our goal is to empower cannabis CEOs, investors, and executives with some basic information so that you can hire the right professionals and know exactly what to expect from your accounting team.*

*Here is a handy guide that CEOs should follow when evaluating current accounting efforts, or when looking to hire their World Class Accounting team. After all, proper accounting practices are not optional for this industry, and are a requirement to maintain licensing and remain compliant. Make sure your accountant, bookkeeper, or CPA is meeting the minimum standards*



# OVERVIEW OF THE SESSION



**WHAT IS 280E & WHAT DOES IT MEAN FOR A CANNABIS COMPANY?**



**EXAMINING RECORDKEEPING REQUIREMENTS & ACCOUNTING BEST PRACTICES**



**OTHER OPERATIONAL GUIDANCE**



**A WORD ON MERCHANT SERVICES, BANKING, & PAYROLL PROCESSING**





**A**

**WHAT IS 280E & WHAT DOES IT MEAN FOR  
A CANNABIS COMPANY?**



## SECTION 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) consist 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.**





**Trade or Business – based on a host of tax case law, but if you are reading this it is safe to say that you have or will have a trade or business**



**Trafficking – US Tax Court Definition “To engage in commercial activity; buy and sell regularly”**

- Most cannabis businesses will meet this definition as well. Pure transportation-only and courier-only businesses may have an argument, but it is untested



**Controlled Substance – Schedule I or II substance**

- **Cannabis is currently on Schedule I**



# What Does This Mean For Cannabis Companies?



**ACCOUNTINGBUDS**  
LET US BE YOUR ACCOUNTING BUDS !



**Due to cannabis' inclusion as a Schedule I substance, all plant touching businesses must follow Section 280e of the tax code**



**This means the cannabis companies are not allowed to take any deductions or credits, even those available to most businesses while calculating their taxes**







**THE SENATE REPORT ACCOMPANYING THE ENACTMENT OF 280E FURTHER ELABORATED ON THE LEGISLATIVE INTENT BEHIND THE PROVISION:**

*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 the effective cost of goods sold is not affected by this provision of the bill.*





# WHAT IS COST OF GOODS SOLD?



**In order to understand Cost of Goods Sold, it is important first to understand how a tax return is constructed.**

- **Gross Income – Cost of Goods Sold = Total Income**
- **Total Income – Deductions = Taxable Income**
- **Taxable Income – Tax Rate = Tax Liability**
- **Tax Liability – Credits = Taxes Owed**

Cost of Goods Sold are direct costs of producing the goods sold by a company and for tax purposes are a reduction of Gross Income while calculating Total Income.





# BACKGROUND: VERTICAL SEGMENTS



**Cultivation**  
**growing**

**Manufacturing**  
**making**

**Distribution**  
**selling**

**Retail**  
**selling**

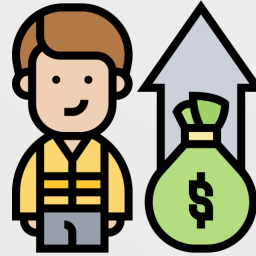




## MATERIAL.

Growing or making – COGS includes materials to grow, make, or enhance a product

Selling – limited to costs relating to purchasing the product sold



## DIRECT LABOR.

Growing or making – COGS includes compensation for employees to grow, make, or enhance a product

Selling – COGS limited primarily to compensation for inventory control employees.



## OTHER DIRECT COSTS.

Growing or making – COGS can include allocations of rent, insurance, utilities, etc.

Selling – COGS limited primarily to allocations to inventory control space.



- ❖ **Many expenses need allocations for optimization of 280e (must follow Section 471 of the Tax Code).**
- ❖ **Best to use accrual method with allocations.**
- ❖ **Must be consistent in application of each allocation.**
- ❖ **Examples of expenses where allocations may be considered:**
  - **Rent – inventory control space**
  - **Utilities – for freezers and warehouse**
  - **Payroll – inventory control or cultivators**



***“Pigs get fat; hogs get slaughtered.” Don’t be a hog!***

**There are many accounting professionals and lawyers that will encourage you to try to “beat” the system or interpret 280E in other ways, but the tax courts have spoken, the IRS is aware of most of the “tricks” being utilized, and it’s not worth paying the penalties if you are wrong.**

**There are ways to correctly do your taxes and minimize them, but make sure your accountant is doing this right or you will be sitting on a big hidden liability.**

**Having experienced cannabis accounting professional support will assist you in making sure that your deductions are within the guidelines set by the IRS so that you don’t end up like the other cannabis companies who failed the beat the IRS in court.**



A hand is shown holding several US dollar bills, with one bill prominently displayed in the foreground. The scene is set on a desk with a laptop and a calculator. The entire image has a blue tint. A white text box is overlaid on the bottom left, containing a large letter 'B' and a title.

**B**

## **Examining Record Keeping Requirements & Accounting Best Practices**



# IMPORTANCE OF PROPER RECORD KEEPING



**ACCOUNTINGBUDS**  
LET US BE YOUR ACCOUNTING BUDS !

**01**

**If a cannabis business is operating without keeping good records, the IRS can deny income reductions related to Cost of Goods sold!**


**02**

**Without proper records, including allocations and calculations, cannabis companies lose their only way to reduce taxable income!**

**03**

**Investors seek GAAP financial statements and solid record keeping. Without proper recordkeeping you may lose the deal you worked so hard to get!**





**Make sure you have written documentation that lists all accounting policies, accounting procedures (who does what, and when), and internal controls & corporate governance (this protects your financials and assets).**

**This is crucial, because when purchases are made or equipment is repaired, you want to make sure that these costs are accounted for and documented properly and consistently. When your business is audited, you'll want to have these procedures handy if questions come up about how you calculated things like depreciation, for example.**



**Store records in an organized fashion so they can be retrieved at any time.**



**Never release an original document.**



**Most accounting general ledgers (ie. Quickbooks) allow you to attach supporting documents to journal entries. Use this functionality to ease audits down the road (or transitions to new accountants!)**



## A STANDARD REPORT IN THE “FINANCIAL STATEMENTS” OF A COMPANY AND REQUIRED PART OF AN INCOME TAX RETURN

### **ASSETS:**

a resource with economic value owned with the expectation it will provide a future benefit. *ex. Cash, Fixed Assets, Inventory, etc.*

=

### **LIABILITIES:**

something a company owes. *ex. Accounts Payable, Loans Payable, etc.*

+

### **EQUITY:**

Owners' book value of the company



# CASH CONTROLS & PROCEDURES



Write down internal procedures for how employees are to deal with cash (especially for retailers). Having systems in place to manage the daily cash count, deposits, cash payments (i.e. petty cash), and reconciliations with the POS system are crucial.

Also, have a plan for how you intend to deal with large sums of cash. Regular deposits will help keep your employees safe, as well as minimize the risk of employee theft. Be sure that someone on your accounting team is reconciling your bank statements and sales, and that all cash is accounted for daily.

Cannabis CEOs, executives, managers, and investors are liable for following the rules in order to maintain their licensing. That means security systems must be in place that watch where cash is kept, where transactions are being processed, and where inventory is being held. If there is ever a question as to whether a cannabis business is paying proper taxes, or is skimming cash to avoid reporting income, state and local authorities may question your cash handling practices and review your footage to determine whether or not you were negligent.





## A WORD ABOUT INVENTORY



The same reasons and rules apply to inventory as cash. In fact, each state has their own “track and trace” software where inventory counts and transfers must be reported, which is why having internal controls and procedures is a must.

*If you intend to claim any Cost of Goods Sold reductions to income, proper cost accounting requires accurate inventory accounting.*

Be sure to implement monthly counts of inventory (handwritten evidence is best), and reconcile with Seed to Sale (ie Metrc), POS system, and accounting software. GAAP (Generally Accepted Accounting Principles) is required (ie. cost accounting) if you want to maximize inventory COGS.

Your accounting team should be well versed and understand the seed to sale process from start to finish in order to help you maximize your COGS. Each month, you should be working with your accounting team to so they can correctly allocate cost between Inventory and Cost of Goods Sold.

Without correct cost and absorption accounting, you will not know key information, such as how much it costs for you to grow a pound of cannabis, so make sure you have a trained cannabis accountant on board.



**Every time cannabis moves, it is recorded with METRC/BioTrack**



**To manage the business owner's inventory correctly, the business' electronic accounting system must account for all inventory movement.**



- **If a company bought product, it did not or could not use it, document it!**
- **Product was bad and could not be used.**
- **Product was poor quality and was returned.**
- **Product was consumed in manufacturing.**



**Inventory adjustments may be passed back through the system to reduce the tax burden.**





**Your business should be keeping accurate general ledgers and subledgers including detailed roll-forwards, to not only remain compliant, but so that you have the information that you need in order to properly run your business and manage capital. An experienced cannabis accountant can help tremendously in this area.**

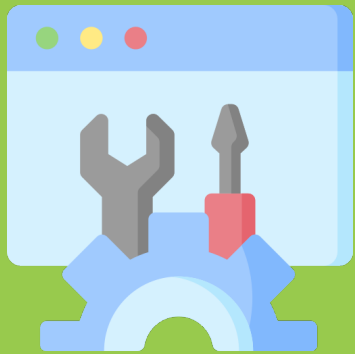
**Your accounting team should be preparing a detailed Month End report that reconciles every Balance Sheet account, including Fixed Assets.**

**Fixed Assets needs a detailed roll forward that shows beginning of period balances, plus additions, less disposals and ending balance.**

**The same is needed for depreciation of fixed assets (which for certain verticals can be included in COGS – but only if calculated according to acceptable accounting methodologies!)**

A large, white, cloud-shaped sign hanging from a thin wire against a light green background. The sign contains the text "Fixed Asset" in a bold, dark grey, sans-serif font.

# Fixed Asset



May include  
equipment cost plus  
installation.



Placed in service date  
is important.



Always a consideration  
of value for the  
business.



Where equipment is  
deployed can be a  
280e consideration.





# LIABILITIES



Having your liabilities (accounts payables, debt, etc.) properly documented will help CEOs and operators properly manage their business and also ensures your financials are complete and accurate.

Accounting professionals should be providing a detailed tie out of each debt account (AP, accrued liabilities, debt, etc.) showing additions, payments, and ending balance reconciled to your general ledger. For the sake of maintaining accurate records, make sure that these reports are complete and include all invoices, debts, and payables.





# STATEMENT OF INCOME OR "P&L"



**A standard report  
in the "financial  
statements" of a  
company.**

**Income = top  
line sales.**

**General and  
administrative  
expenses.**

**Provision of  
income taxes.**

**The report which  
turns into the  
calculation of  
income tax due.**

**Cost of Goods  
Sold.**

**Net income after  
tax.**



This goes without saying... you can't run a business without knowing how much you sell. And the IRS and the state are not messing around. They want to know about every transaction that goes in and out of your business.

Each month, your accounting team should reconcile the point-of sale system, state Seed to Sale system, deposits, merchant service reports, cash counts, and accounting software. The valuation of your company is based mostly on revenues (in the cannabis industry), so make sure that this accounting is rock solid, or you will lose value at exit.





- ❖ **We have discussed Cost of Goods Sold in detailed earlier, so we will not cover it again here, other than to say certain expenses can be allocated to COGS for certain verticals.**
- ❖ **Each cannabis vertical must allocate significant expenses in different ways in order to be accounted for correctly and minimize their tax liability. Have your accounting team scrutinize these reports regularly and handle the finer details of these accounts so that your business is compliant, and taxes are minimized.**
- ❖ **Your accounting team should be able to help you find a payroll company that is cannabis friendly, provides accurate reporting, and makes sure that these costs/expenses are allocated properly. Any other sizeable accounts need to be reviewed on a monthly basis.**

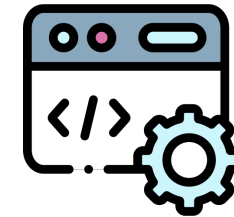




**Record sales by date, by customer and by income type.**



**Reconcile Sales (& Inventory) between POS, Seed to Sale (i.e., METRC), and your books.**



**Electronic accounting software should generate invoices and track payments received.**



**Record expenses by date, vendor and expense type.**



**Attach invoices, receipts, and delivery manifests to expenses in your accounting software.**



**Don't forget about sales taxes and other local taxes!**



## **OTHER OPERATIONAL GUIDANCE**



**Develop systems which will have:**

- Least moving parts
- Most automation
- Best documentation, both from provider as well as within the business
- Some layer(s) of access for control



**Look for “off the shelf” software. There are several good ones.**



**Be sure the system can be easily audited internally and externally.**



**Be sure the management and outside professionals can efficiently obtain any necessary information. May be lawyers, accountants, strategic planners, M&A, marketing and sales.**





**Hire the employees based on experience, potential, and cultural fit.**



**Be sure that there is an employee manual and other company standard operating procedures (“SOP’s”) in place.**



**Consider using outside experienced resources and/or “Fractional” personnel to help the business fill out its staffing requirements. (This can be a very cost-effective method of building out a team)**



**Build separation of duties into the design of individual roles & responsibilities as well as the organizational chart as a whole.**







**Cannabis is one of the most regulated and taxed industries in the U.S.**



**Develop internal auditing procedures in order to ensure your employees are following procedures, ensure that your company stays in compliance, and minimize the concern for errors and missions in reporting.**



**Internal auditing helps to ensure that you are prepared for the inevitable audits by external agencies.**



**Auditing can touch every part of the business.**

- *Personnel and Human Resources*
- *Sales department*
- *Inventory management*
- *Supply chain*





**Cannabis is one of the most regulated and taxed industries in the U.S.**



**Compliance is a super, vital responsibility for a cannabis company.**

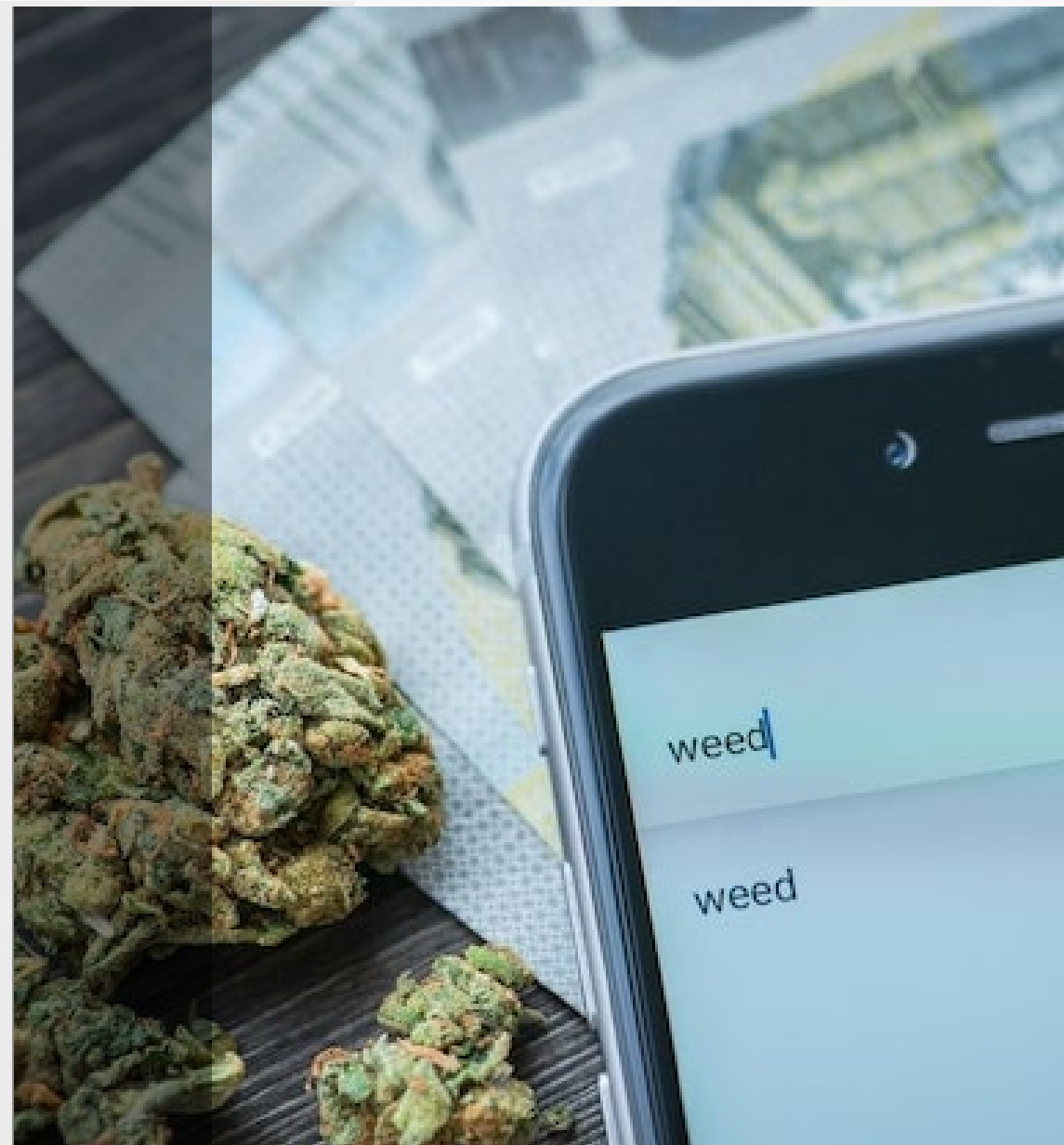


**Compliance is everchanging because the industry is so new. Build procedures into your SOPs to ensure the company stays abreast of new rules and regulations.**



**Areas that require particular attention:**

- ***Branding***
- ***Marketing (advertising & social media)***
- ***Packaging***
- ***Product distribution***





**Work with your accounting team to develop actionable financial reports, dashboards, and analysis to help management run the business.**



**Create Operating Budgets and review Budget to Actual reports on a regular basis.**



**Ensure that your accounting team builds processes to prepare & deliver any reports that your bank/lenders may need for monthly compliance purposes. Failure to do this could result in your bank account being suspended or your loan being "called" and due immediately!**



**Pay attention to details in equity accounts.**



**D**

**A WORD ON BANKING, MERCHANT SERVICES,  
CASHLESS ATMS, & PAYROLL PROCESSING**



**ANYONE THAT HAS BEEN IN THE CANNABIS INDUSTRY FOR EVEN A SHORT PERIOD OF TIME HAS HEARD HORROR STORIES OF BANK ACCOUNTS AND MERCHANT SERVICES ACCOUNTS BEING TERMINATED.**

Since Cannabis is still federally illegal, banks that have a federal charter cannot accept any funds from cannabis companies, without risking losing their federal charter.

DO NOT try to trick your bank by not disclosing that you are a cannabis company, they will eventually find out. (And this is technically fraud)

State chartered banks and credit unions are usually your best bet to get a cannabis friendly bank account.

Cannabis friendly bank accounts come at a cost. Look at this expense as a cost of doing business, similar to a cannabis license fee. Cannabis friendly banks need to do a lot of compliance work, hence the fees.

Expect to be asked to provide monthly reports to your cannabis friendly bank to assist them in performing their compliance work, as a requirement to keep your account active.

If you need help finding a cannabis friendly bank, your accountant can usually help!





There is no legal solution to accept major credit cards in the industry due to it being federally illegal. All major credit card providers also have cannabis as an exclusion in their terms and services (meaning they don't accept cannabis in any way, shape or form).

This includes services like Square, PayPal, Stripe, etc. Square is well known to search social media posts, and perform other deep internet searches, shutting companies down without any warning and holding their funds hostage for a long period of time. Its not worth it!

It is fraudulent to intentionally miscode transactions to hide them from credit card companies. Just ask the C-Suite at Eaze that are all in jail for coding cannabis transactions as retail clothing sales!

**CASHLESS ATMS ARE 100% ILLEGAL REGARDLESS OF WHAT ANY PROVIDER TELLS YOU.**

Providers try to get around the rules by coding transactions as ATM transactions, however that code can only legally be used for the physical box type ATM machines. Any other use is fraud. And while its true everyone uses them; do you want to be the one made an example of?

PIN Debit (using the debit system and not "rounding up") and Venmo-like solutions are promising but the legality remains untested.





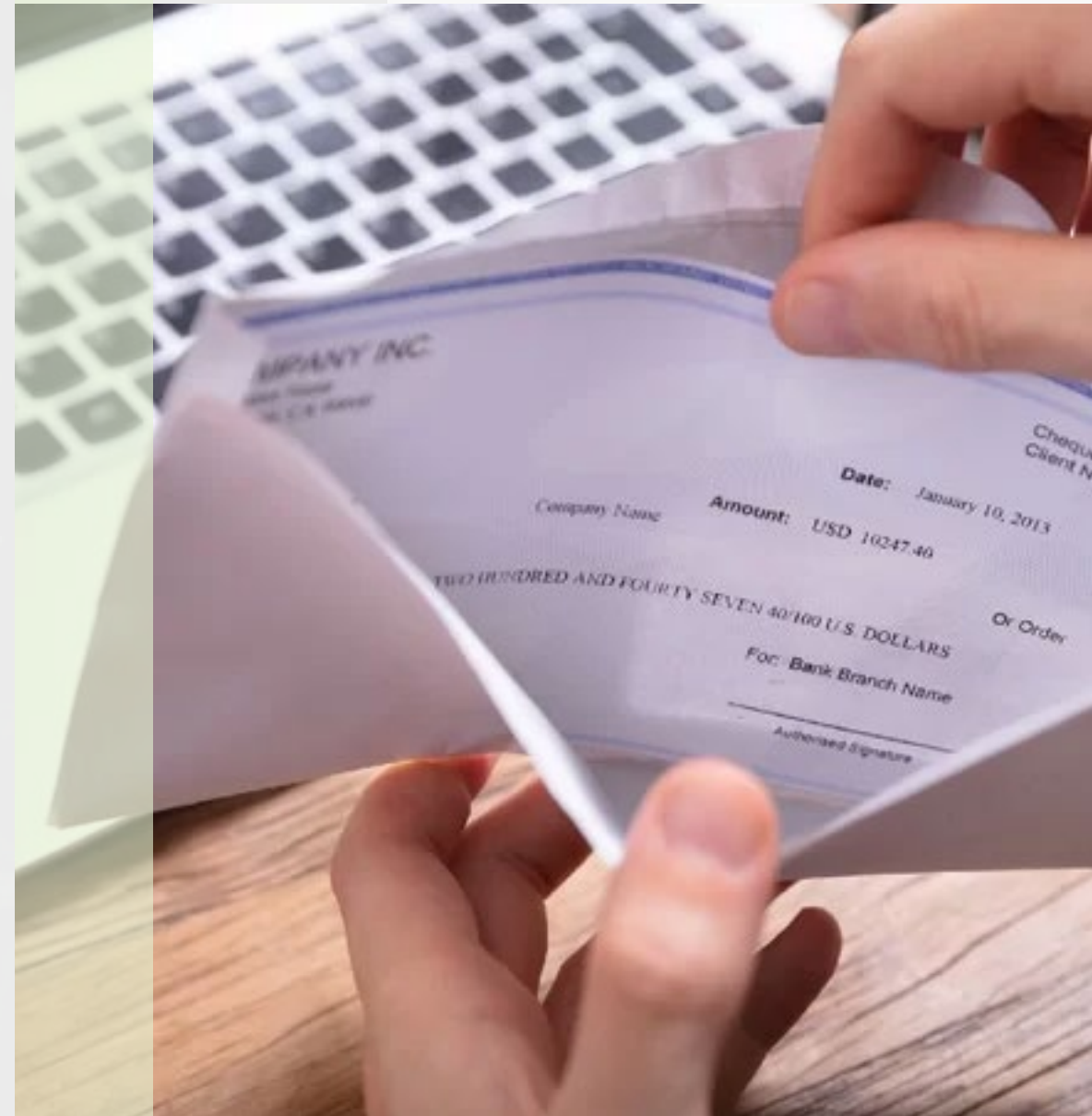
Payroll is another area in the industry that is difficult to find cannabis friendly providers due to the movements of large sums of funds.

Again, Do Not try to lie to a payroll provider to get them to process your payroll.

There are a handful of cannabis friendly payroll providers popping up that are great. Again, they may cost a few dollars more than a typical payroll provider, but it is well worth it.

Many even come with some assistance with HR functions as a part of their services!

Talk to your accountant if you need help finding a cannabis friendly payroll provider.





**ACCOUNTINGBUDS**  
LET US BE YOUR ACCOUNTING BUDS !