

# Cannabis Accounting 101

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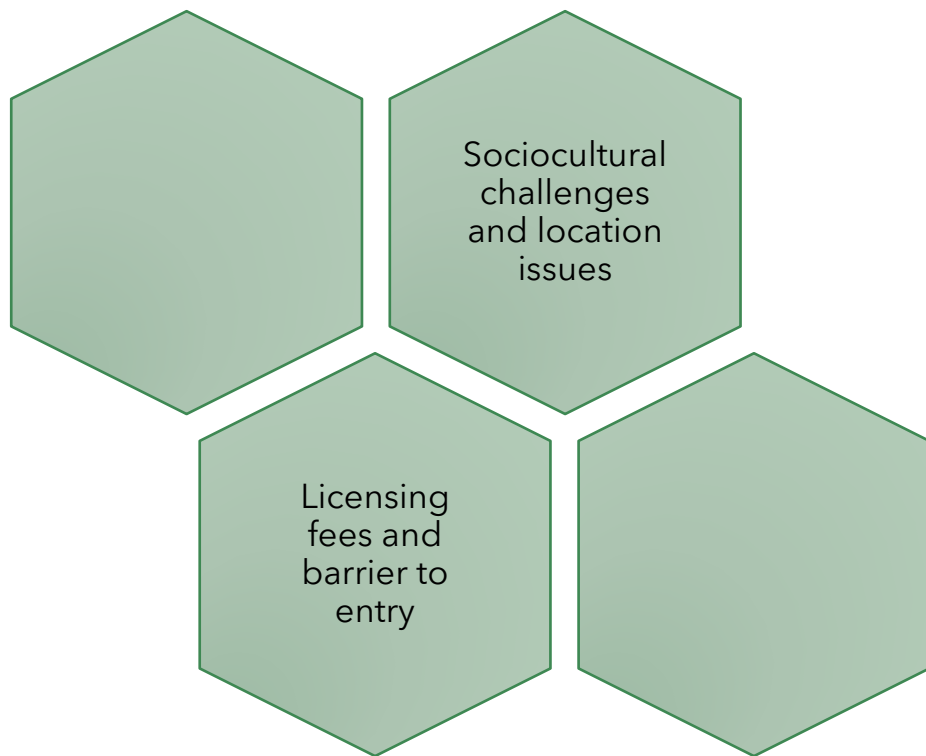


# Introduction to the Cannabis Industry

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\$70B Industry  
by 2021

\$10B made up  
of retail and  
dispensaries



# Introduction to Cannabis Industry

# Basics of the Industry

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HEMP VS. MARIJUANA - KNOW  
WHAT YOU'RE WORKING WITH



CBD VS. THC - WHY  
ACCOUNTANTS NEED TO  
UNDERSTAND THE DIFFERENCE

# Polling Question:

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Why do accountants need to know the difference between THC and CBD Products?

- A. It's important to understand client products
- B. In case we want to sample a product
- C. We can't provide services to THC customers
- D. It has a significant impact on a client's accounting and tax deductions

# The Product Mix

Salve

Tincture

Oil

Foods & Beverages

Gummies

Capsules

Pet Treatments

What Does  
Schedule 1 Mean?

# Schedule 1 and § 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.”



# State Issues & Reporting

Every state has its own licensing regulations

Each state has its own seed to sale management system that clients are required to use

Massachusetts was the first to develop Economic Empowerment

Some states require certain pieces of a vertically integrated business to be held in a non-profit

IS YOUR LICENSE  
AT RISK?

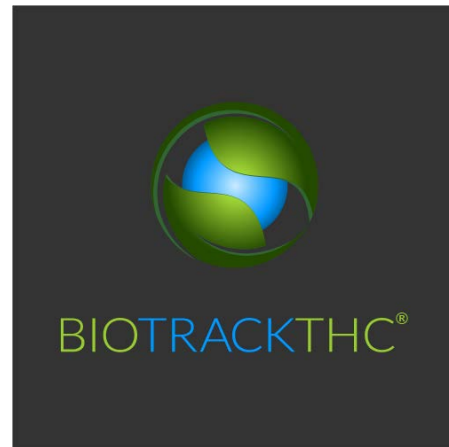
# CPA Licenses & Cannabis Concerns

# Point of Sale Systems

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IndicaOnline



MJ FREEWAY

# Polling Question:

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Cannabis businesses get to choose which point of sale system they want to work with.

- A. True
- B. False

# Cannabis Accounting 101: Top Challenges

- All cannabis businesses MUST follow Generally Accepted Accounting Principles to take advantage of tax deductions
- 280E significantly hinders tax deductions
- Cost accounting must be fully documented and able to be audited

# Balance Sheet Issues

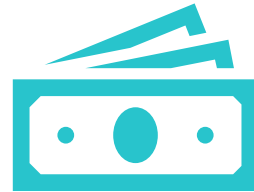
- Cash Banking Challenges
  - Daily cash counts
  - Armored truck services
  - Frozen deposit issues
  - High fees
  - Internal control challenges
  - ATMs on site
  - Form 8300

# Cash Banking Challenges

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Credit unions and  
private trust



Money orders



Rotating accounts

# Form 8300

IRS Form (Rev. August 2014)  Department of the Treasury Internal Revenue Service	<b>8300</b> <b>Report of Cash Payments Over \$10,000 Received in a Trade or Business</b> ▶ See instructions for definition of cash. ▶ Use this form for transactions occurring after August 29, 2014. Do not use prior versions after this date. For Privacy Act and Paperwork Reduction Act Notice, see the last page.	FinCEN Form (Rev. August 2014) OMB No. 1506-0018 Department of the Treasury Financial Crimes Enforcement Network
<b>1</b> Check appropriate box(es) if:    a <input type="checkbox"/> Amends prior report;    b <input type="checkbox"/> Suspicious transaction.		
<b>Part I Identity of Individual From Whom the Cash Was Received</b>		
<b>2</b> If more than one individual is involved, check here and see instructions . . . . . <input type="checkbox"/>		
<b>3</b> Last name	<b>4</b> First name	<b>5</b> M.I.
SMITH	JANE	J
<b>7</b> Address (number, street, and apt. or suite no.)		<b>6</b> Taxpayer identification number
7 MAIN STREET		0 1 1 2 3 4 5 6 7 8
<b>9</b> City		<b>8</b> Date of birth . . . . . ▶ M M D D Y Y Y Y
ANYWHERE		(see instructions) 0 1 0 1 1 9 7 0
<b>10</b> State	<b>11</b> ZIP code	<b>12</b> Country (if not U.S.)
C I T	06000	
<b>14</b> Identifying document (ID)		<b>13</b> Occupation, profession, or business
a Describe ID ▶ DRIVERS LICENSE c Number ▶ 234567890		b Issued by ▶ CONNECTICUT
<b>Part II Person on Whose Behalf This Transaction Was Conducted</b>		
<b>15</b> If this transaction was conducted on behalf of more than one person, check here and see instructions . . . . . <input type="checkbox"/>		
<b>16</b> Individual's last name or organization's name	<b>17</b> First name	<b>18</b> M.I.
SMITH	JOSEPH	J
<b>20</b> Doing business as (DBA) name (see instructions)		<b>19</b> Taxpayer identification number
		1 2 3 4 5 6 7 8 9
<b>21</b> Address (number, street, and apt. or suite no.)		Employer identification number
7 MAIN STREET		: : : : : :
<b>23</b> City	<b>24</b> State	<b>25</b> ZIP code
ANYWHERE	C I T	06000
<b>26</b> Country (if not U.S.)		<b>22</b> Occupation, profession, or business
		STUDENT



# Balance Sheet Issues

- Inventory Challenges
  - Work In Process Internal Controls
  - Seed to Sale Tracking
  - Grow Cycles
  - Inventory importance to 280E
  - Required POS reporting issues

# Inventory Tracking

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Inventory Asset	OCASSET	1400
Inventory Asset:Raw Materials	OCASSET	1401
Inventory Asset:Work In Process	OCASSET	1402
Inventory Asset:Cap Direct Costs (WIP)	OCASSET	1403
Inventory Asset:Cap Indirect Costs (WIP)	OCASSET	1404
Finished Goods Inventory	OCASSET	1420
Finished Goods Inventory:Flower Inventory	OCASSET	1421
Finished Goods Inventory:Pre-rolls	OCASSET	1422
Finished Goods Inventory:Plants	OCASSET	1423
Finished Goods Inventory:Tinctures	OCASSET	1424
Finished Goods Inventory:Trim	OCASSET	1425
Finished Goods Inventory:Samples & R&D	OCASSET	1426
Finished Goods Inventory:Seeds	OCASSET	1427

# Balance Sheet Issues

- Fixed Assets
  - Depreciation options
  - 280E application

# Balance Sheet Issues

- Most common departures from GAAP:
  - Following the cash basis
  - Asset valuation
    - Lower of cost or market on inventory
    - Goodwill following M&A activity

# Balance Sheet Issues

- Liability Challenges
  - Limited lending services
  - Inability to deduct interest expenses
  - Personal lending issues for employees and owners

# Income Statement Issues

Absorption Cost Accounting

Separate non-cannabis divisions

# Polling Question:

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What is the tax code that prohibits most deductions for cannabis businesses?

- A. IRC 471
- B. IRC 280E
- C. The code of conduct
- D. IRS Form 8300

# Income Statement Issues

- Internal controls for absorption cost accounting
  - Defining direct materials
  - Defining direct labor
  - Variable overhead allocation
  - Fixed overhead allocation



# Absorption Costing

# Variable Costing



# IRS Absorption Cost Accounting

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To be able to use the full absorption regulations, you must be considered a manufacturer. In Rev. Rule. 81-272, the IRS describes types of businesses that are considered manufacturers. Examples include:

1. A company sells printed towels. The company purchases white towels and contracts with an unrelated party to furnish the dye and design work. They have title to the towels at all times. When the dye and design work are completed, the company stores, packages, and markets the towels.
2. The facts are the same as in example 1, except the unrelated contractor, in addition to dyeing and designing the towels, also stores, packages, and distributes the finished product to the company's customers.
3. A company purchases individual parts of dolls, assembles them, and markets the finished product.
4. A company produces goods naturally, such as the aging of whiskey,

# Income Statement Issues

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- Absorption costing considerations
  - This needs to be done by product type (i.e. tincture, salve, bud, etc.)
  - Month end close should include assigning costs to cost pools for the product types
  - Calculate usage
  - Assign costs
  - Adjust to lower of cost or market before expensing for finished goods

# Fixed Manufacturing Overhead

- Rent
- Utilities (may also be variable)
- Depreciation

# Variable Manufacturing Overhead

- Equipment Utilities
- Production Supplies
- Materials Handling Wages

# Cannabis Considerations

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- Trimming
- Milling
- Drying
- Lab testing
- Oils
- Soft gel capsules
- Packaging
- Shipping
- Licensing

# Nondeductible expenses under Sec. 280E

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In 1982, Congress enacted Sec. 280E, which reversed a Tax Court decision (*Edmondson*, T.C. Memo. 1981-623) that had allowed deductions incurred in carrying on the production, distribution, and sale of controlled substances. Sec. 280E reads:

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 the 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 the context of marijuana, trafficking was defined by the Tax Court as the regular buying or selling of marijuana (*Californians Helping to Alleviate Medical Problems (CHAMP), Inc.*, 128 T.C. 173 (2007)).

Sec. 61(a) taxes "all income from whatever source derived," which includes income from illegal activities (see, e.g., *James*, 366 U.S. 213 (1961)). The 16th Amendment to the Constitution gave Congress authority to tax income from any source without apportionment. The U.S. Supreme Court has held that income in the context of a reseller or producer means gross income, not gross receipts. In other words, Congress may not tax the return of capital (see, e.g., *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179 (1918)). This concept is bolstered under Sec. 61(a)(3), which provides that gross income includes only net gains derived from dealings in property. In addition, Regs. Sec. 1.61-3(a) defines gross income as total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources (see also *Rodriguez*, T.C. Memo. 2009-22, in which the Tax Court clearly states that cost of goods sold is an adjustment to gross income and not a deduction; see also Regs. Sec. 1.162-1(a): "The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income.").



# Grow Cycles

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# Spoilage

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Normal spoilage



Abnormal spoilage

# Polling Question:

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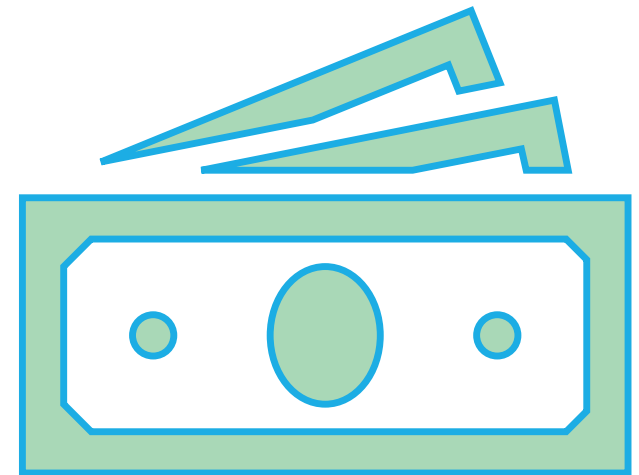
Which of the following are true for cannabis businesses:

- A. They can deduct normal operating expenses
- B. GAAP Accounting Principles might be helpful but is not required
- C. Using Lower of Cost or Market for inventory is just a suggestion
- D. None of the above

# Income Statement Issues

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- Depreciation and amortization challenges
- Book to tax differences
- Accrued income tax liabilities
- Accrued sales tax liabilities



Sole proprietorships  
are not a good  
recommendation for  
this industry



Highly recommend  
clients consider a  
corporate status



Management and  
real estate holdings  
companies are not  
going to save tax  
dollars

Legal Entity  
Structure

# Software Issues

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- QuickBooks is not cannabis friendly
- Other vendor considerations (and how to pay them):
  - Lawyers
  - Insurance agents
  - Lending officers
  - Financial advisors
  - Payroll processors



# Polling Question:

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What is the best legal structure for a cannabis business?

- A. A corporation
- B. A single member LLC
- C. A sole proprietorship
- D. Whatever form the owner wants

# Cannabis Accounting 101

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CHRISTINE DEANGELIS, MSA,  
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Consulting Services  
CPE Classes  
Outsourced CFO Services  
Outsourced Tax Preparation

REFER TO CODE: 420

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ENGAGEMENT