How Cannabis Dispensaries Can Maximize Federal Tax Deductions

Dispensaries can't deduct expenses the way most businesses do – but there is a way.

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Tax season is a stressful time for any business owner, but cannabis entrepreneurs have additional concerns to consider. These go beyond navigating their cannabis software POS to determine tax liability.

For example, the federal government doesn't explicitly recognize cannabis dispensaries as legitimate businesses, but it also wants to collect taxes from them. In fact, cannabis dispensaries not only need to pay federal taxes but are also barred from claiming deductions on business expenses.

What the Federal Tax Code 280e Says About Cannabis

Here is the specific wording of the relevant section of the federal tax code 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."

This means that cannabis dispensaries must pay taxes on all of their revenue without being able to deduct business expenses the way most organizations do. However, some tax-savvy cannabis entrepreneurs have found ways to maximize deductions despite this law.

The Cannabis Taxes Exemption: "Cost of Goods Sold"

While federal law prohibits dispensaries from claiming the vast majority of business deductions, some exceptions do exist. The most important one that cannabis entrepreneurs can use is the *cost of goods sold* deduction, which allows dispensaries to deduct inventory costs and other directly related expenses from their taxes.

However, the IRS offers a narrow definition of what costs are deductible in this context. This often means that cannabis dispensary owners must use less advantageous accounting methods to calculate and pay their federal taxes.

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Separate the Dispensary Into Multiple Companies

Another popular method for minimizing tax liability is separating the dispensary into multiple companies that work together to run the overall business. Under this approach, the legal entity that operates the cannabis dispensary is distinct from the one that provides care services, sells ancillary items, or manages property on the dispensary's behalf.

This arrangement allows cannabis dispensaries to maximize deductions by incurring costs on specific organizations according to their respective tax structure. For instance, dispensary employees may work for minimum wage (as dispensaries cannot deduct employee compensation costs) while also receiving compensation from an ancillary company (which can deduct compensation costs).

However, it's vital to consult with a tax expert before attempting this strategy on your own. While there is a legal precedent for holding this kind of arrangement up in court, it does not give cannabis entrepreneurs the freedom to skirt their tax obligations entirely. The federal tax court has successfully prosecuted dispensary owners who attempted to take things too far.

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Sources:

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