Colorado Cannabis and The Federal Tax Code

How a Dated and Draconian Federal Regulation is Strangling the Legal Marijuana Industry

While the legal cannabis industry is growing and public perception is that cannabis companies are swimming in revenue, these headlines fail to mention a glaring problem that is actually creating quite the opposite effect.
Serious problems with the federal tax system are actually bleeding businesses dry and forcing many legal cannabis industry partners to close their doors for good.

The major culprit is Section 280(e) of the IRS federal tax code, which prevents legal cannabis businesses from deducting normal business expenses from their taxes. This means that normal business expenses such as wages, employee benefits like health insurance and paid sick days, rent, and equipment are all treated as profit and taxed. In fact, cannabis businesses currently face tax rates at more than 70%, which is up to 3.5 times more than all other businesses face.

Background On 280e:

In the 1980's Congress passed IRS tax code 280(e), which mandates that businesses selling Schedule 1 or 2 federally illegal drugs may not deduct normal business expenses from their taxes outside of the cost of the goods sold. Even though **marijuana is legal in some form in a majority in 38 US states,** marijuana remains illegal at the federal level. This prevents Colorado's legal cannabis companies from deducting their business expe
businesses get to deduct.

The Numbers:

The chart to the right demonstrates the difference between how a Colorado cannabis business is taxed and how other Colorado busineses are taxed under the federal code. Both companies sell $1M worth of goods and have $500,000 for their cost of those goods sold expenses. The non-280(e) company in the right hand column would be able to deduct their $325,000 of expenses from their federal tax bill. This means these businesses are only charged federal taxes on the $175,000 in net income so they pay only $45,000 in federal income taxes. This makes their effective tax rate 26%.

On the other hand, Colorado's legal marijuana businesses fall under the 280(e) category and face the challenges outlined in the left hand column. They have the same exact costs as the non-280e company, but unlike all other Colorado small businesses, they are prohibited from deducting their usual business expenses. This means the federal government charges them "income" tax on the full $500,000, hitting them with a massive $125,000 tax bill, an effective tax rate of 71%.

Sample budget	280E	Non 280E
Income	**1,000,000**	**1,000,000**
Cost of Goods Sold	500,000	500,000
Gross Margin	**500,000**	**500,000**
%	*50%*	*50%*
Expenses	**325,000**	**325,000**
Wages, salaries, benefits	175,000	175,000
Other expenses	150,000	150,000
Net income before tax	**175,000**	**175,000**
Income tax	125,000	45,000
Net income	**50,000**	**130,000**
%	*5%*	*13%*
Effective tax rate	***71%***	***26%***

While the non-280(e) company earns a profit of $130,000, the 280(e) marijuana business earns a net profit of only $50,000 despite having identical expenses.

Impacts on Marijuana Small Businesses:

The 280(e) tax code means that the federal government has made it much more expensive for Colorado's marijuana small businesses to grow. But it also means that it has disincentivized marijuana business from providing community benefits that we all value such as more and higher paying jobs, and employee benefits like health insurance, sick leave and family leave.

This financial reality also flies in the face of the perception that the marijuana industry is swimming in money. Along with the massive tax bills from the federal government under 280(e), the cannabis industry also faces state, local, and municipal taxes.

In Denver, for example, here are all of the sales taxes on marijuana, adding up to over 42%:

1. *15% - Colorado Excise Tax*
2. *15% - Colorado State Cannabis Retail Tax*
3. *5.5% - Denver Retail Marijuana Tax*
4. *4.81% - Denver Municipal Sales Tax*
5. *1% - RTD*
6. *1% - Cultural Facilities*

What we saw in November, 2021 though, is that voters understand that the marijuana industry isn't a piggy bank. **Voters in 59 of 64 counties voted no on Proposition 119. They sent a clear message that new taxes cannot continue to be piled on to the marijuana industry.**

The hard truth is the industry cannot continue to function under a broken federal tax system and under the threat of additional new state and local taxes.

About the Marijuana Industry Group (MIG):

MIG was founded in 2010 by cannabis business owners and supporters who wanted to help craft Colorado's earliest medical marijuana regulatory framework. MIG is the oldest and largest trade association for licensed cannabis businesses. Comprised of approximately 400 licensed businesses, MIG has strong representation and connections across the state. MIG advocates on behalf of the rapidly evolving needs of the regulated marijuana industry in Colorado with a reputation for innovative policy making and getting results for the state's cannabis community.