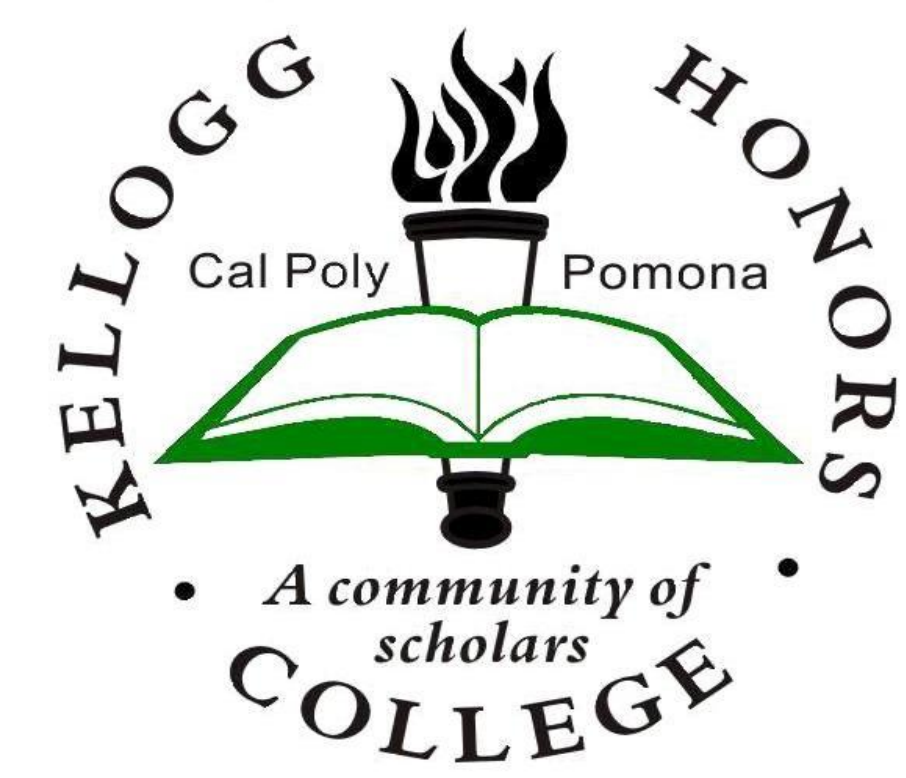


# Accounting for the Cannabis Industry



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### Abstract

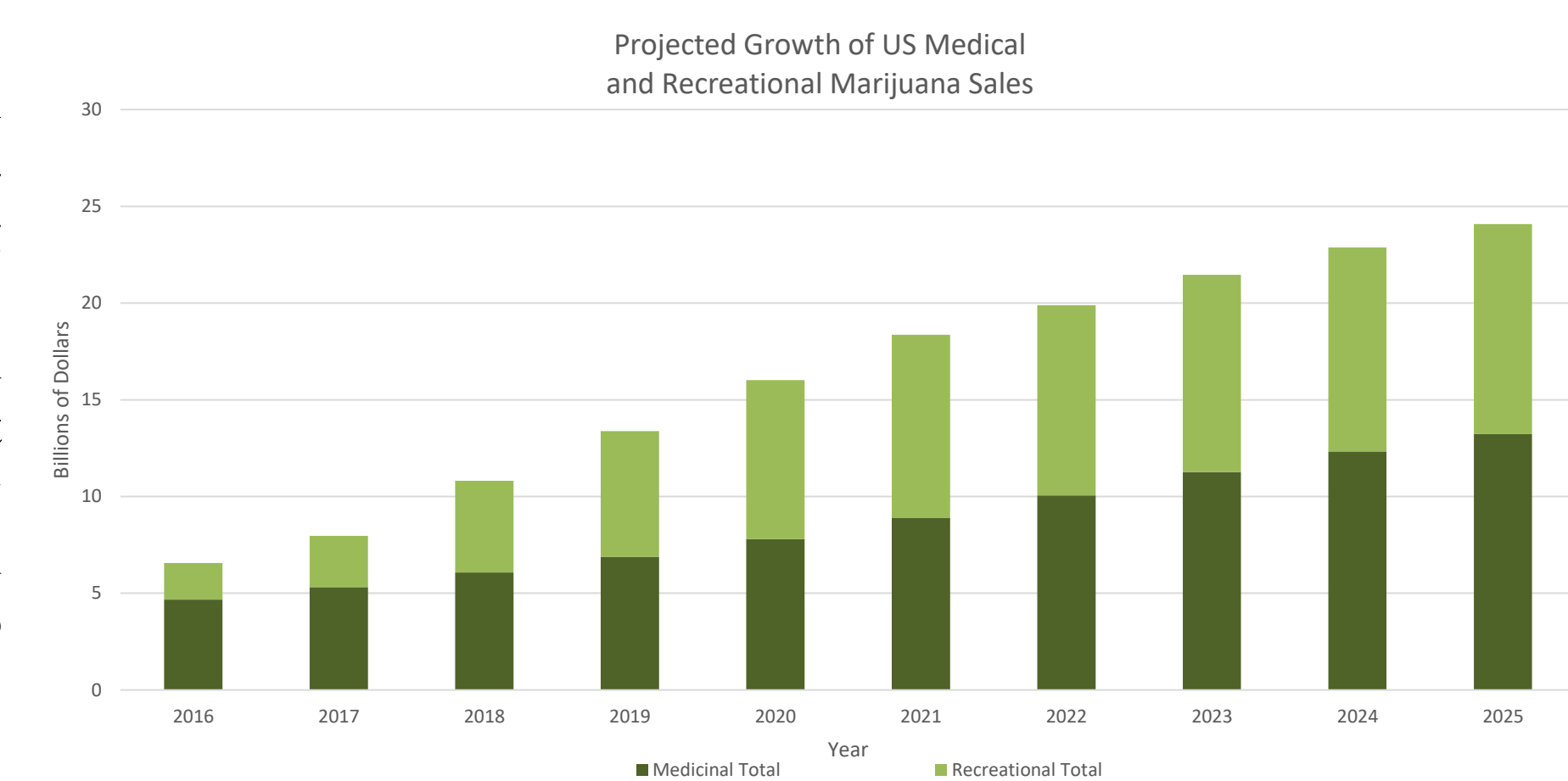
The cannabis industry is one that is rapidly growing in the United States of America. This research poster will delve into this particular niche and the difficulties, opportunities, and implications of this growing industry as are relevant to taxes and some financial implications. This topic is relevant because it is relatively unexplored but booming after the legalization of marijuana in multiple states. Those who sell marijuana are subject to significant tax burdens since they cannot take deductions that normal businesses can. Additionally, since the recreational usage of marijuana is federally illegal, federal banks do not accept cannabis business monies or accounts. This leads to cannabis businesses being primarily cash businesses, which in turn makes it even harder for accountants to track transactions. Also, cannabis businesses struggle to find a reputable accountant, since many firms do not accept marijuana clients. Finally, even though cannabis is illegal federally, federal taxes must be paid on the revenues acquired from the distribution of marijuana. As there are various challenges within this industry in the realm of financial reporting, this poster will explore some of the problems that professionals have come across so that the industry can be better understood as a whole.

### Background

There are multiple species of the cannabis plant. *Cannabis Sativa*, which is commonly referred to as marijuana or weed, contains the psycho-active cannabinoid THC. Throughout this poster, when referencing marijuana, weed, or cannabis, I am referencing *Cannabis Sativa*. Legal marijuana is the fastest growing business in the United States. It is expected to have a 400% increase in sales in the past five years, with the projected sales for 2019 to be 10.8 billion compared to 2.7 billion in 2014. (ArcView Market Research) The sale and use of marijuana, or cannabis, is federally illegal under 21 U.S.C. § 811 of the US code. However, states have individually legalized marijuana both medicinally and recreationally. California was the first state to legalize the drug medicinally in 1996. However, it was not until 2012 that Washington became the first state to legalize cannabis recreationally. Now, in 2019, nine states and the District of Columbia have legalized the drug both medicinally and recreationally. Many more are predicted to follow in the coming years.

### Snapshot and Significance of the Cannabis Industry

There are three main categories of cannabis businesses: infused product manufacturing, retail sales, and cultivation. There are many types of business opportunities that are sprouting up in the marijuana industry. Some of these include edible companies, cannabis accessories, security services, and technology development. Some of these lines are especially lucrative, such as the accessories business, because it avoids selling the actual illegal drug. This study is significant because of the growth of the cannabis industry. Projections state that over 25 states will legalize marijuana for sale both recreationally and medicinally in the next 5 years. This impacts this market greatly and will surely bring not only more companies into the market, but also more cannabis accountants. Before studying this market, I had not given much thought to the cannabis industry. However, I see now how important a deep understanding of section 280E is to this industry and how necessary knowledgeable accountants are to this type of business. In the future, I would consider becoming an expert in this field to reduce the taxes that marijuana businesses pay.



### The Market for Cannabis Accountants

With the booming industry of cannabis, there is much demand for qualified CPAs. However, established accounting firms are wary to accept these types of clients because of the federal illegality of their industry. Those who are willing and qualified to help cannabis clients across the country is a very limited number. "I'd say 10 nationwide," a CPA from Oakland, California, Luigi Zamorra, said. He has worked with businesses related to marijuana for 10 years. However, that number is growing as the demand grows. In fact, accountants who already practice in the cannabis industry are encouraging their associates to take on marijuana clients as well to lighten the influx and heavy workload. In coming years, there is a projection for more accountants and bookkeepers to enter the industry, especially those who desire to grow their practice. In conjunction, more guidance and instructions from accountant organizations and boards is projected to be released, further persuading those on the fence to join the ranks of financial professionals in the industry. For many CPAs, the marijuana industry is not their first choice for specialization. However, many have come to the realization that the market for cannabis is booming and exuding opportunities for accounting firms to provide services to marijuana-related businesses in the areas of audit, tax, accounting, and business issues.

### Difficulties in the Cannabis Industry

There are many difficulties in the financial reporting spectrum of cannabis. Firstly, those who sell and grow marijuana are required to file federal income tax returns, despite the drug's federal illegality. However, marijuana businesses are considerably limited in the deductions they take because of section 280E of the US tax code. This states that, "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 consists of trafficking in controlled substances." Payroll, advertising, and rent, expenses that are commonly deducted by businesses in America, cannot be taken as deductions for cannabis-related businesses. Section 280E is seen as one of the highest barriers to entry for the cannabis industry, with many businesses having to pay 40-70% of their earnings in taxes. One way that businesses go around this rule is by using other "legal" subsidiaries and moving as many costs as legally possible to those entities instead of the marijuana one. For example, a marijuana company might own another subsidiary that sells garden tools at Walmart (something legal). The marijuana company will funnel as many of its expenses as possible, including rent, advertising, and payroll, to the subsidiary that is selling the legal garden tools. Another way that companies attempt to go around 280E is by including labor expenses in the calculation for the cost of goods sold (in this case, marijuana). Since COGS is deductible for tax purposes, companies add labor expenses into that cost instead of keeping it out of the equation. Another challenge that marijuana companies face is the fact that the market price of marijuana has decreased in the past few years; some say as much as 40% in the last five years. An ounce of quality product on the black market, which would have sold for \$400 a few years ago (before legalization) now sells for \$175. Despite these challenges, profits are still attainable, but are sometimes difficult to reach. Even some businessowners in the industry see an advantage to the lower margins and prices and large tax bills, saying it is the reason that large alcohol and tobacco companies are not in the market right now. Issues with the IRS are actually seen as a chance for these new companies to grow, establish market share, and build out their brands.

Another issue that cannabis companies face is the storing of their cash. Marijuana is illegal federally, so the majority of these businesses' transactions are carried out in cash. Because of the federal illegality, banks are wary to accept marijuana clients. They could be federally prosecuted for storing money from illegal activities in their accounts. With some marijuana companies dealing with cash in millions of dollars, one could see how this presents a problem. Outside companies have jumped into the cannabis market to provide a solution and a place for these companies to accumulate their monies. One such company that is based in California, called PayQwick, functions as a Paypal for pot. It allows companies and customers to use PayQwick cards or an app (which are connected to other bank accounts) to pay for cannabis products, avoiding the issue of not being allowed to use a credit or debit card in store. Not only can customers use it for their transactions, but processors and retailers can also use PayQwick to pay each other. More avenues for saving cash and using it in transactions are popping up, but they are still few and far between. As long as banks and other financial institutions can be held liable for the actions of their marijuana clients, there will be a lack of places for cannabis businesses to store their capital.

### Summary and Conclusion

Overall, there are many pros and cons to the marijuana industry. In this poster, I have attempted to look at the industry as unbiased as possible by not considering the ethicality or correctness of the legality of marijuana as a whole. I have simply sought to provide a snapshot of some of the trends in accountancy in the industry, as well as some of the financial reporting issues that these cannabis companies face. As one can see, there are many issues, but by looking at the growth in the industry, the benefits for many outweigh the costs. It will be very interesting to see if, in the future, the growth projections are correct or not and cannabis gets legalized in even more states. As the opportunities for cannabis production and distribution grow, so will the openings for more financial accounting experts and financial institutions that seek to have cannabis clients. This industry should be on everyone's radar in the coming years as people seek to have an understanding as to how the cannabis industry should be accounted for.

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