



§ 280E

General

If you're working in cannabis, there is little doubt that you haven't heard about 280E! What does 280E mean though and how does it impact a cannabis business? The below summary describes Internal Revenue Code Section 280E, how it came to be, and how it generally applies to cannabis businesses. The resource links provide expanded information that can be helpful to review with your CPA. It is important to work with a CPA who not only understands what 280E is, but specifically how it will affect your business's calculation of taxable income.

Definition

IRC Section 280E, titled Expenditures In Connection with the Illegal Sale of Drugs, is included under the list of code sections describing items that are not deductible. Specifically, § 280E 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 (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."

Read Section 280E here: [§ 280E](#)

History

§ 280E was enacted by Congress in 1982 in reaction to a Tax Court decision the year before in which the Court allowed a taxpayer to deduct expenses incurred in an illegal drug trade. The IRS originally denied the taxpayer's business expenses in connection with the sale of amphetamines, cocaine, and marijuana; the Tax Court however found that these expenses were ordinary and necessary for the taxpayer's trade or business and allowed them. Marijuana is included within the Controlled Substances Act under Schedule I substances. (See CSA § 812)

Resources:

[Edmondson v Commissioner Case](#)

[Tax Equity and Fiscal Responsibility Act of 1982: Public Law 97-248 \(See Sec. 351\) - Where § 280E was added to the law.](#)

[Senate Finance Committee Report on Tax Equity and Fiscal Responsibility Act \(See page 312 of the PDF\)](#)



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Application

Section 280E disallows deductions from gross receipts when computing taxable income for ordinary and necessary business expenses. At the time it was enacted, concerns were raised that 280E did not allow within the scope of the Sixteenth Amendment a disallowance of cost of goods sold when determining gross income, or, generally, an adjustment for the return of capital. The assumption that cost of goods sold is an allowable adjustment to reduce gross receipts has since consistently been upheld by the Tax Courts and IRS.

Effectively, cannabis businesses must compute their federal taxable income as their gross receipts less cost of goods sold when applying 280E, resulting in taxable income equal to their gross profit. The calculation of cost of goods sold is the cost of inventory sold during the given period, based on inventory valuation rules under Internal Revenue Code Section 471. General, selling, and administrative expenses are in general, not includible as allowable expense deductions.

When calculating taxable income for Michigan income tax purposes, businesses operating with an adult use license under the Michigan Regulation and Taxation of Marihuana Act may decouple from 280E, and are allowed a deduction for ordinary and necessary business expenses.

In Michigan, the Michigan Regulation and Taxation of Marihuana Act (MRTMA) allows for the decoupling from 280E for operations under this law for state income tax purposes. This means that when calculating state taxable income, MRTMA license holders may generally deduct their ordinary and necessary business expenses related to adult-use activities, as if 280E did not apply. At this time however, medical use license holders under the MMFLA are not afforded this same treatment when calculating their taxable income, and must apply 280E.

Read the: [Congressional Research Service Publication - The Application of Internal Revenue Code Section 280E to Marijuana Businesses: Selected Legal Issues 3.10.2021](#)

Court Challenges

There have been several challenges to § 280E, both in terms of its applicability and constitutionality. Tax Courts have consistently held that ordinary and necessary expense deductions are not allowed for cannabis (marijuana) businesses because of 280E, and only Congress has the power to change this law. Specifically, the Tax Courts have addressed and denied deductions for ordinary and necessary business expenses, charitable contributions, depreciation, and losses for marijuana businesses.

While there have been numerous court challenges centered around 280E and tax issues impacting cannabis businesses, two of the cases considered to be landmark cases include those known as CHAMP and Harborside.

[CHAMP Case](#)

[Harborside Case](#)