

# 280E Tax Compliance: Complete Resource for Cannabis Businesses

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Master 280E compliance with our comprehensive guide covering deductions, record-keeping, and audit preparation

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## 1. What is 280E?

Section 280E of the Internal Revenue Code was enacted in 1982 to prevent drug dealers from deducting business expenses. While originally targeting illegal drug trafficking, it now applies to all

businesses that traffic in controlled substances, including state-legal cannabis businesses.

### **Key Points About 280E**

- Prohibits deduction of most business expenses
- Allows deduction of Cost of Goods Sold (COGS)
- Applies to all cannabis businesses, regardless of state legality
- Can result in effective tax rates of 70% or higher

## **2. What You CAN Deduct**

Under 280E, cannabis businesses have very limited deduction options. Understanding what you can deduct is crucial for tax planning and compliance.

### **Cost of Goods Sold (COGS)**

- Direct materials (seeds, nutrients, packaging)
- Direct labor (cultivation, processing, packaging)
- Direct overhead (facility costs, utilities, equipment depreciation)
- Transportation and storage costs

### **Limited Administrative Expenses**

- Accounting and bookkeeping services
- Legal services (compliance-related)
- Tax preparation and planning

- Certain professional services

## 3. What You CANNOT Deduct

Most traditional business expenses are off-limits under 280E. This is where many cannabis businesses make costly mistakes.

### ✗ Common Non-Deductible Expenses

- Marketing and advertising
- General administrative expenses
- Rent and utilities (unless directly related to production)
- Insurance (except product liability)
- Professional development and training
- Travel and entertainment
- Office supplies and equipment

## 4. COGS Calculation

Proper COGS calculation is essential for 280E compliance. The IRS requires specific methods for calculating and documenting COGS.

### COGS Calculation Methods

- **Specific Identification:** Track individual product costs

- **FIFO (First In, First Out):** Assume oldest inventory is sold first
- **LIFO (Last In, First Out):** Assume newest inventory is sold first
- **Weighted Average:** Calculate average cost per unit

### **COGS Calculation Example**

**Direct Materials:** \$50,000

**Direct Labor:** \$30,000

**Direct Overhead:** \$20,000

**Total COGS:** \$100,000

## **5. Record-Keeping Requirements**

280E compliance requires meticulous record-keeping. The IRS expects detailed documentation for all expenses and COGS calculations.

### **Essential Documentation**

- Detailed expense receipts and invoices
- Inventory tracking records
- Employee time sheets and payroll records
- Vendor contracts and agreements
- Bank statements and cash transaction logs
- COGS calculation worksheets

## 6. Audit Defense Strategies

Cannabis businesses face higher audit risk due to 280E compliance issues. Proper preparation and documentation are your best defense.

### Audit Preparation Checklist

- Organize all financial records chronologically
- Prepare detailed COGS calculations
- Document expense categorization rationale
- Maintain inventory tracking records
- Prepare written policies and procedures
- Have professional representation ready

## 7. Tax Planning Tips

Effective tax planning can help minimize your 280E impact and maximize legitimate deductions.

### Strategic Tax Planning

- Maximize COGS deductions through proper categorization
- Consider separate business entities for different activities
- Implement proper inventory management systems
- Plan for estimated tax payments
- Consider state tax implications

## Need Help with 280E Compliance?

Our team specializes in 280E compliance and can help you maximize deductions while staying audit-ready.

[Get Free Consultation](#)[Download 280E Guide](#)