

February 15, 2024

HouseFinance@rilegislature.gov

Chair Marvin L. Abney and
Members of the House Finance Committee
State House
Providence, RI 02903

Re: Public Comment in Support of Provisions of Sections 12 and 22 of Article 6 Related to Allowing Cannabis Establishments to make Lawful Deductions

Dear Chair Abney & Members of the Committee:

My name is Brian Silva. I am a practicing CPA and have worked in tax for 12 years. I am currently a Partner with Withum Smith+Brown, PC in Providence, Rhode Island. Our firm has a very large practice in the cannabis space, and I respectfully thank you for allowing me to testify in support of the provisions of Sections 12 and 22 of Article 6 of the Governor's proposed budget related to allowing cannabis establishments to make lawful deductions.

As you know, with certain exceptions, Rhode Island taxable income is calculated utilizing amounts from a taxpayer's federal income tax return. As such, cannabis businesses, whether they be cultivators, dispensaries, retail or medical, are subject to the provisions of Internal Revenue Code (IRS) Section 280E (26 USC §280E). Section 280E of the IRS Code reads as follows:

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.

The enactment of Section 280E in 1982 was in response to a taxpayer victory in *Edmondson v. Commissioner*, TC Memo 1981-623. In that case, a taxpayer selling illegal substances was allowed deductions for ordinary and necessary expenses when preparing his tax return. Congress sought to overturn this result by enacting Section 280E, but allowed cost of goods sold deductions to remain, fearing a constitutional challenge if taxing gross receipts.

Of course, cannabis is still a Class I controlled substance at the federal level. Therefore, despite being lawful, licensed cannabis establishments under Rhode Island law are only permitted deduction for their cost of goods sold. An example of the impact of the different treatment of cannabis establishments to other retailers is attached as Exhibit A. The impact of Section 280E can result in very harsh consequences to business owners. The schedule does not even consider other taxes, such as self-employment tax imposed federally.

Costs to produce cannabis, again as defined in IRS regulations under Code Section 471, can be utilized to reduce taxable income for cultivators and manufacturers. Operating costs not allocable to production (professional fees, office supplies, administrative payroll, etc.) are not deductible. Dispensaries may only deduct the costs of the goods they acquire; these businesses may have significant overhead costs such as payroll, rent, utilities, equipment and storage costs, and security to name a few. They cannot deduct significant expenses, like application or licensing fees, which in Rhode Island can be up to \$125,000. There is also the significant cost of the technology required so that these business enterprises can properly comply with Rhode Island sales and cannabis taxes.

Although 22 states have now authorized the use of cannabis for adult use and 38 states have authorized cannabis for medical use, the federal government has yet to reform Section 280E. A growing number of states have recognized this conflict and passed 280E tax exemptions at the state level, such as California, Colorado, Connecticut, Hawaii, Illinois, Maryland, Massachusetts, Michigan, Minnesota, New Jersey, New York and Oregon. Other states have proposed legislation to address it, such as Delaware, Missouri, and Oklahoma.

As Massachusetts and Connecticut have de-coupled from 280E, potentially contributing to lower prices in both states, Rhode Island may soon be surrounded by states that have empowered their local businesses to offer better prices to consumers. Without a similar exemption from the heavy tax burden created by 280E, Rhode Island cannabis businesses will be at a competitive disadvantage.

Passing this bill will help Rhode Island businesses stay strong and compete with businesses from nearby states. Given the legitimacy of cannabis businesses in Rhode Island, and the revenue they produce in the form of income taxes, sales taxes, and cannabis taxes, I respectfully suggest that the Committee support these proposed amendments and that Rhode Island de-couple from the Federal 280E provisions.

Thank you for your consideration of this important issue.

Respectfully yours,



Brian A. Silva, CPA/MBA
Partner, Withum Smith+Brown, PC

EXHIBIT A

The High Tax Burden of 280E

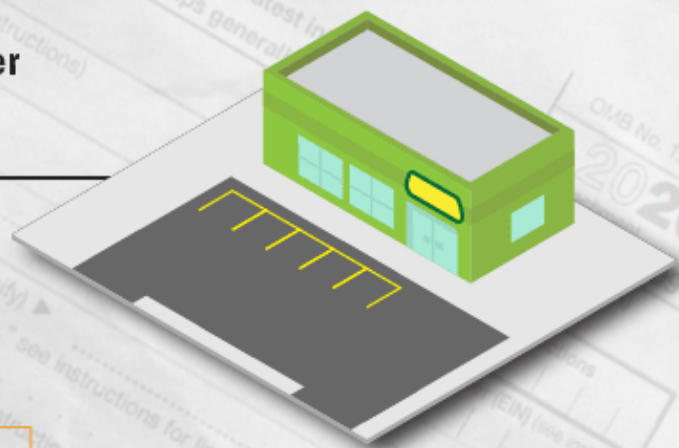
Congress added Section 280E to the Internal Revenue Code in 1982 to prevent any company that traffics in Schedule 1 or Schedule 2 substances, such as marijuana, from taking standard business deductions. How that impacts state-legal marijuana companies compared to other businesses:



Marijuana retailer
State-legal licensed dispensary or rec shop.



Traditional retailer
Non-cannabis licensed retailer.



Revenue	\$1,000,000	\$1,000,000
Rent	\$100,000	\$100,000
Utilities	\$100,000	\$100,000
Insurance	\$50,000	\$50,000
Maintenance	\$50,000	\$50,000
Cost of Goods Sold.....	\$500,000	\$500,000
Taxable Income	\$500,000	\$200,000
Tax Burden at 25%	\$125,000	\$50,000
Income After Taxes & Expenses	\$75,000	\$150,000

Standard business deductions
The marijuana retailer cannot deduct these expenses, while the traditional retailer can.

Cost of goods sold
Both retailers can adjust their taxable income based on the costs of the goods they are selling. These include wholesale cost, delivery, storage.

The traditional retailer ends up with double the income of a marijuana retailer despite having the same expenses and revenue.

Source: Marijuana Business Factbook, Propublica fonts

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