HOSPITALITY
INFORMATION MEMO
SEPTEMBER 6, 2022

Tax Tips for New York Cannabis Businesses

Businesses looking to enter New York's recreational cannabis industry should be pleased to know recent changes to state tax laws are slowly making the venture more financially feasible. Ever since New York passed the Marijuana Regulation and Taxation Act (the Act) in 2021, which legalized recreational possession and use of cannabis for those over the age of 21, it has continued to develop financial regulations related to cannabis. However, despite New York's focus on its own cannabis industry, the use of cannabis remains illegal at the federal level. Due to this divide, cannabis businesses must consider tax implications at both the state and federal levels.

Federal Tax Treatment of Cannabis

Cannabis is still considered an illegal, schedule I substance under the Controlled Substances Act. Under Section 280E of the Internal Revenue Code, businesses may not deduct expenses related to schedule I substances unrelated to cost of goods sold (COGS), which is basically the cost of a business' inventory. This means costs like wages and salaries, overhead, advertising and travel expenses do not count against, thereby reducing, your taxable income each year. These expenses are often necessary for general business operation and, when not reported, will increase a business' year-end tax liability. If not planned for, this can lead to an outcome as extreme as your tax bill exceeding any profit your business makes on the year.

While federal tax implications remain harsh, there are strategies that can help cannabis businesses lessen their tax obligations. Depending on your business' operations, these strategies can involve the restructuring of your organization in order to bifurcate the cannabis-specific business from management operations.

New York State Tax Treatment of Cannabis

Many states mirror federal tax policy when developing their own tax laws. If adopted without change, Section 280E would have the same effect on a cannabis business' state tax deductions as it does on its federal tax deductions. However, Gov. Kathy Hochul recently signed off on New York's Fiscal Year 2023 budget which grants an exemption from Section 280E for cannabis businesses under state law. The exemption permits cannabis businesses to claim tax deductions and credits at a state level that are otherwise excluded under Section 280E, thereby providing significant savings at the state level.

New York State Sales Taxes on Cannabis Products

Additionally, the Act established three state taxes that apply to cannabis businesses operating in New York. The first is charged to the distributor and depends on the amount of THC in a given product:

- Edibles (food and beverages) are taxed at $0.03/mg of THC;
- Concentrates (vaporization oil, wax, shatter and resin) are taxed at $0.008/mg of THC; and
- Cannabis flower (loose flower, pre-rolls or shake) is taxed at $0.005/mg of THC.

The second and third taxes are charged to consumers. Consumers will pay a state excise tax of 9% and a local excise tax of 4% on all cannabis products purchased.

Tax Tips

The tax implications for cannabis businesses are evolving in a direction that generally favors business owners. In order to take advantage of current tax rules, cannabis businesses should consider following these suggestions:

1. Limit overhead and expenses that are unrelated to COGS, including items like rent, utilities, advertising and wages. If a non-deductible expense isn't absolutely necessary, trim it down or eliminate it entirely.
2. Consider establishing an alternative business structure that utilizes a management company or an employee leasing organization.
3. Report all cash payments. If a cannabis business receives more than $10,000 in cash in a single transaction or in related transactions, they must file IRS Form 8300 within 15 days after receiving payment. Business owners should be very diligent about this.
4. If able, take advantage of the Employee Retention Tax Credit to offset wages.
5. Stay up to date on current tax trends at the state and federal levels.
6. Think local! Should the Internal Revenue Service place "health" requirements on cannabis products to qualify them for removal from the controlled substances list, businesses that utilize local growers or producers that are "Sun + Earth certified" or "biodynamic and regenerative" farming practices would be ahead of the curve.
7. Help educate your target market—businesses will likely need to charge higher prices to offset paying cannabis-related taxes at both the federal and state levels. To fend off competition from similar businesses who do not pay the same taxes, focus on product quality and informing consumers about the realities of the industry. Only illicit-market cannabis can be priced at $10/gram—an unsustainable price for tax-paying businesses. People need to understand why paying more supports local, quality shops and farms doing the right thing.
8. Do not expand your business without a valid reason. Cannabis businesses are not yet permitted to transact across state lines.
9. If seeking financing, look for long term options at reasonable interest rates.
10. Ensure your tax advisors have experience with Section 280E filings and issues.

If you have any questions about any of the information provided above or the cannabis industry in general, please contact Dustin M. Dorsino, Jeffrey B. Scheer or the Bond attorney with which you are regularly in contact.

BOND SCHOENECK & KING ATTORNEYS