My name is Kevin Haller, and I am an Oregon and California CPA. I have been serving the cannabis industry since 2015, providing assurance, tax, and advisory services. Four out of five businesses fail within the first five years of operations. The fail rate in cannabis will be greater due to strict compliance, high taxes at the federal, state, and local jurisdictions, and the illicit market that is still connected with most consumers. The perception is because cannabis was deemed essential during the pandemic (which resulted in record high sales) that the industry is thriving. This logic would normally be reasonable; however, this is not the case. Cannabis businesses are struggling and will continue to struggle until cannabis is rescheduled or legalized.

Since cannabis is federally illegal, cannabis businesses are subject to IRC §280E (280E). The code states "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." Cost of goods sold is a reduction in income, therefore, businesses can ONLY deduct cost of goods sold. If you are a retailer, this means you can only deduct the cost of cannabis purchased, and maybe incidental labor and packaging materials if the jurisdiction allows retail to package goods (not permitted in California). According to the National Cannabis Industry Association, retailers have a federal tax rate upwards of 70%.

Let us say a business has sales of $1M, with $500k of cost of goods sold (cannabis purchases), and $400k of operating expenses (rent, payroll, insurance, local taxes, security, utilities, etc.), resulting in net income before taxes of $100k. At a federal tax rate of 22% (which will likely increase to 28% under the new administration), the company will have a federal tax liability of $110k (22% times $500k gross profit), resulting in a net loss of $10k before state taxes which increase the loss further. Same fact pattern above however now the business is not a cannabis business. The federal taxes would be $22k (22% times $100k). By design, 280E is intended to be punitive. As a CPA, I am always asked "how do I get around 280E?" The answer is you cannot if you want to be compliant. There are also bad CPAs that will give false hope, which will contribute to more than four out of five businesses failing when the IRS audits come.

Raising taxes will provide short-term revenue for the state but will have major long-term consequences. Since this industry has operated in the illicit market for so long, most consumers have access to illegal products. In many jurisdictions, like CA, the illicit market is thriving. CA has the chasing dollars mentality, where they tax cannabis businesses every step of the way, which is why more than 80% of cannabis sales are still on the illicit market (no tax revenue, payroll taxes, etc.). Increasing taxes will increase the price passed on to consumers, resulting in lost sales to the illicit market, evident in CA. If CA reduced these taxes, they would make way more tax revenue through increased sales.

I urge this committee to consider the cause and effect of increased taxes. Instead of chasing dollars like CA, focus on addressing the real issue preventing these businesses from thriving, which is federal legality. Until cannabis businesses can deduct operating expenses, they will never thrive. I would like to point out these proposed increased taxes are not inventoriable costs, and therefore not deductible for tax purposes for these businesses, adding to the problem. I thank you for your time. I am available should anyone have questions or would like to discuss anything further.