

## **Public Comment Before the Committee on Taxation In Support of L.D. 1063**

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March 30, 2023

Senate Chair Grohoski, House Chair Perry, and members of Taxation Committee:

My name is Hannah King. I am a partner in the Cannabis Practice Group of Dentons, a global law firm with offices in Portland, Maine. I have practiced cannabis law since 2015 and represent hundreds of clients in the cannabis space. I have been an active participant in legislative and regulatory changes to the medical and adult use cannabis laws and regulations since 2016. I was appointed to two terms on the Marijuana Advisory Commission as a representative of the adult use cannabis industry. I am here today on behalf of Mainly Holdings, LLC, which operates an adult use cultivation facility in Bethel, Maine to provide comment in support of L.D. 1063.

Under current state and federal tax laws, specifically, Internal Revenue Code 280E and 36 M.R.S. 5122 (collectively, hereinafter “280E”), state legal adult use cannabis businesses, unlike all other legal businesses, cannot deduct ordinary business expenses and instead are taxed on their gross income. This means that these companies are often taxed on money that has already been spent on operating cost and pay an effective tax rate of 70-90% whereas similarly situated businesses that can deduct ordinary business expenses are paying an effective tax rate of 28-30%.

The reason for this is that cannabis continues to be a Schedule I drug under the federal Controlled Substances Act. State and federal tax laws prohibit businesses trafficking in a Schedule I or Schedule II drug from deducting ordinary business expenses. It is nearly impossible for businesses subject to 280E to remain both tax compliant and viable. In fact, this is precisely the point of 280E. 280E was intended to make: (1) it unfeasible for illicit businesses to comply with their tax obligations so as to discourage participation in illicit enterprises; and (2) enable federal and state governments to prosecute illicit enterprises that failed to meet the onerous tax burden under the tax laws (in addition to the underlying violations of criminal law).

Application of 280E to state legal marijuana businesses is making it difficult for these businesses, which are licensed by the state and authorized under state law, to survive let alone thrive. It is also discouraging people from transitioning to the legal market. Given that Maine has legalized adult use cannabis businesses and has a vested interest in these businesses, who employ thousands of Maine residents and, even without 280E, contribute significant income tax, sales tax, and excise tax revenues to the state, it does not make sense that these businesses would continue to be subject to the state equivalent of 280E. Many other states, including California, Colorado, Hawaii, Michigan, New York and Oregon, have recognized this and amended their laws to exempt state legal cannabis operators from their state equivalent of 280E.

The state counterpart to 280E already exempts medical cannabis companies, allowing them to deduct ordinary business expenses under state law. This change was made before the Cannabis Legalization Act, which legalizing adult use cannabis and creating a regulatory frame work for adult use cannabis businesses, was adopted and, thus, they were not included. As a result, state legal medical cannabis companies can deduct ordinary business expenses, but adult use companies cannot.

This bill would simply amend Title 36 to give adult use cannabis companies the ability to deduct ordinary business expenses, the same way the law was amended for medical cannabis businesses, and subject these businesses to the same tax treatment as all other legal businesses in the state. For these reasons, I urge you to support it.

## **LD 1063 An Act to Provide Equitable Tax Treatment to State Licensed Cannabis Businesses**

LD 1063 would amend Title 36 to treat all state licensed cannabis businesses like other businesses in the state by allowing them to deduct ordinary business expenses under the state tax code.

### **Why should adult use cannabis businesses be exempted from the state equivalent of 280E\*?**

- Most equivalent medical cannabis businesses are already exempt under state law. *36 MRSA §5200-A(2)(GG); 36 MRSA §5122, sub-§2, ¶TT.*
- 280E is intended to prevent illegal businesses from deducting ordinary business expenses. Adult use cannabis businesses that are operating with a license in Maine are legal under state law. Thus, the state equivalent of 280E should not apply to them.
- The purposes of 280E is to discourage people from operating businesses subject to 280E. Subjecting state licensed cannabis businesses to 280E, and not just illicit operators, undermines the policy goal of encouraging all cannabis operators to seek a license from the state and operate in compliance with state law.
- Many of the states that have legalized cannabis, including California, Colorado, Hawaii, Michigan, New York and Oregon, have amended their laws to exempt state legal cannabis operators from their state equivalent of 280E.

### **\*What is 280E?**

Internal Revenue Code Section 280E, enacted under the Regan administration in 1982, disallows certain ordinary and necessary business expense deductions related to sales of Schedule I and II drugs, including marijuana (otherwise known as “cannabis”). Some examples of business expenses that are disallowed under Section 280E for all cannabis businesses are advertising, rent, legal and professional fees, and wages for employees not directly involved in production activities. As a result of this disallowance, the effective federal income tax rate for many cannabis retail stores and other marijuana businesses can exceed 70% or more of net income, and in some cases has exceeded 100% of net income. Since Maine’s income tax code currently follows the federal income tax code for purposes of Section 280E, the total income tax burden on these businesses is further compounded.

The purpose of 280E was to make it impossible for illicit businesses to comply with their tax obligations so as to discourage participation in illicit enterprises and enable federal and state governments to prosecute illicit enterprises that failed to meet the onerous tax burden for tax evasion (in addition to the underlying violations of federal criminal law). Application of 280E to state legal marijuana businesses is making it difficult for these businesses, which are licensed by the state and authorized under state law, to remain viable. It also discourages people from transitioning to the legal market.

The chart below demonstrates the variable cost of running a cannabis business. While many of these are partially offset by costs of goods sold for cultivation and manufacturing businesses, none of these can be deducted due to IRC 280E.

**The cost of opening a cannabis business**

Item	Low	Medium	High
Application fee (non-refundable)	\$2,500	\$30,000	\$100,000
License fee	\$25,000	\$200,000	\$500,000
Annual registration/renewal fee	\$5,000	\$60,000	\$100,000
Real estate	\$128/sq ft	\$240/sq ft	\$393/sq ft
Utilities	\$1.75/sq ft	\$2.10/sq ft	\$2.50/sq ft
Renovations	\$57/sq ft	\$60/sq ft	\$77/sq ft
Security installation	\$75,000	\$100,000	\$135,000
Marketing	3% of sales revenue	5% of sales revenue	9% of sales revenue
Staffing	\$13/hr	\$15/hr	\$20/hr
Inventory (\$/lb)	\$400/lb	\$2,200/lb	\$4,000/lb

*(Sources: Good Tree Capital and Covat)*

**Table 1:**

**Illustration of Cannabis vs. Non-Cannabis Business Federal Tax Burden**

Gross Revenue  
 Cost of Goods Sold  
 Gross Income  
 Deductible Business Expenses  
 Taxable Income  
 Tax Due (30% Rate)  
 Effective Tax Rate

	CANNABIS BUSINESS	NON-CANNABIS BUSINESS
Gross Revenue	\$1,000,000	\$1,000,000
Cost of Goods Sold	\$650,000	\$650,000
Gross Income	\$350,000	\$350,000
Deductible Business Expenses	\$0	\$200,000
Taxable Income	\$350,000	\$150,000
Tax Due (30% Rate)	\$105,000	\$45,000
Effective Tax Rate	70%	30%