2024 Year-End Tax Planning

Cannabis Operators

MEET THE SPEAKERS

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MEET THE SPEAKERS

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Poll Question 1

How interested are you in exploring strategies to improve cash flow for your cannabis business?

Today’s session qualifies for one CPE credit. You must answer three of our four polls today and remain online for >50 minutes.

Cash Flow Improvements

Cash Flow Analysis

- Who needs to improve cash flow?
- Important to have a cash flow projection
  - 13 week
  - At least 2 years on a quarterly basis
- Through benchmarking and analysis of best practices, able to suggest improvements
- One significant area is tax optimization

Cash Flow Improvements

Efficiencies

- New subsidiary, CannCount, to tackle operational efficiencies
- Use data to support strategic decisions with regards to strain selection
- Augments existing services provided by OAFC, Tax, and BITC but with an operational slant to further assist clients with cash flow improvements
- Assess grow areas, retail operations, and inventory areas
- Analyze market and benchmarking data

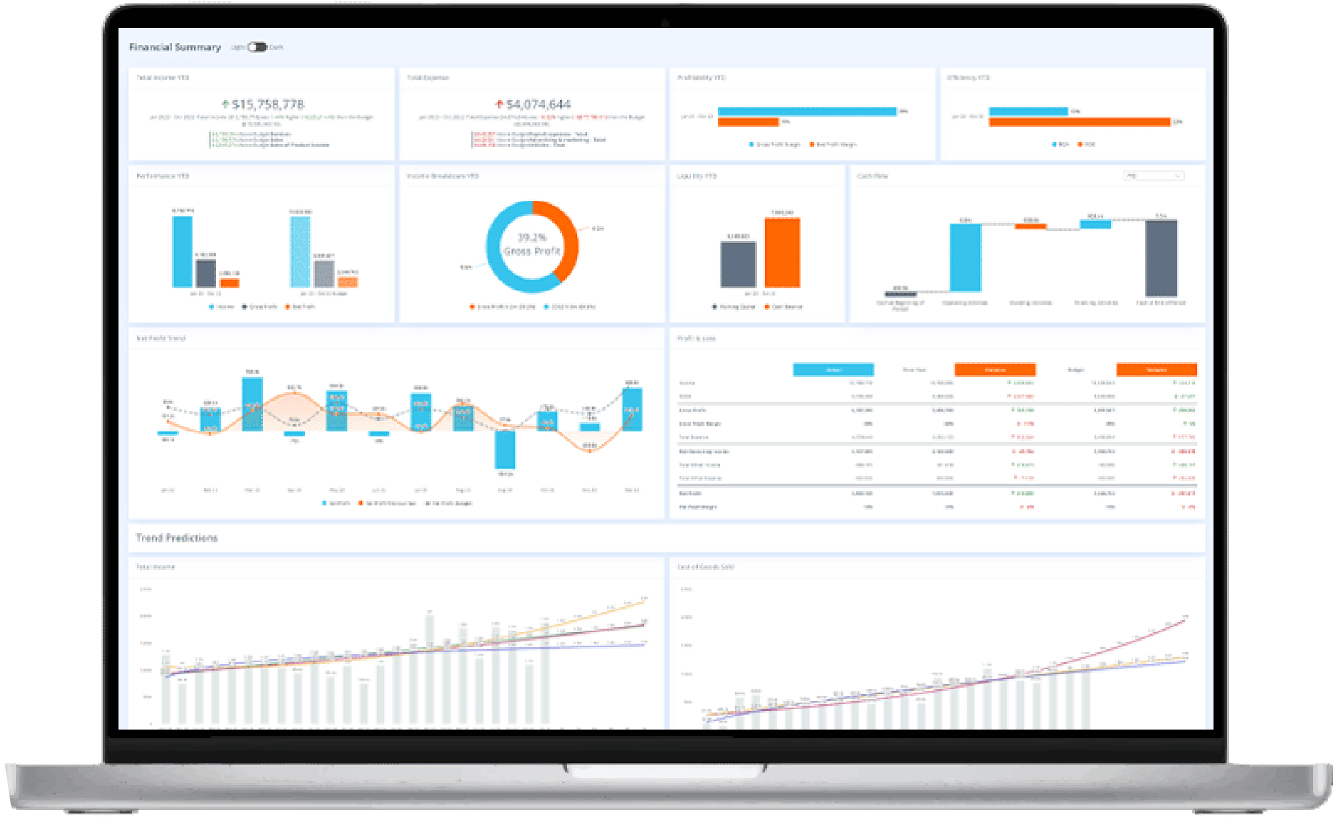
Cash Flow Improvements

Optimizing Tax Strategy

- Tax returns are based on accounting records
- Critical to properly classify costs between cost of goods sold and operating
- Payroll, rent, depreciation, fees, certain taxes, and other expenses potentially may be allocated to CoGS
- Fixed Asset Tracking CoGS and Operating
- Inventory Costing and 471c

Analytics can help:

- Cash flow projections (particularly for distributions or tax payments)
- Budgeting
- Metrics to scrutinize sales data, gross margins, CoGS, inventory, and any unusual items
- Benchmarking



280E

280E – What is it and what does it do?

“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.”

- Non-COGS expenditures cannot be deducted.
- Artificially high effective tax rates (as high as 70-80%)

280E – Where are we going?

- Federal rescheduling is in the works.
  - October 2022 – Biden administration instructs HHS to begin rescheduling.
  - August 2023 – HHS makes recommendation to DEA.
  - April 2024 – DEA announces they will propose a rule to reschedule.
  - July 2024 – Public comment period closed. (~43,000 mostly positive comments)
  - December 2024 – ALJ "preliminary hearing"
  - January/February 2025 – Final ALJ hearing
- DEA Final Determination
  - DEA will review all findings and make determination
  - Litigations
- 2024 Presidential Election

280E – What now?

What options do you have to mitigate 280E while we wait for rescheduling?

- Play Waiting Game – Do Nothing
- IRC 471(c) – Books and Records Method
  - Proper Disclosures
- Follow in the footsteps of the MSOs
  - Claim 280E doesn't apply to state legal cannabusinesses
  - Tax Opinion and Proper Disclosures
- Previous Years
  - Amended Returns
  - Protective Claims

What does a post-rescheduling world look like?

What Rescheduling Does

- Removes 280E!!
- Helps to Level the Playing Field
- Research Opportunities
- Sophisticated Tax Planning

What Rescheduling Doesn't Do

- Rescheduling ≠ Legalization
- Banking
- Interstate Markets
- Bankruptcy
- Previous Incarcerations

Poll Question 2

Have you considered filing your 2024 taxes without 280E?

Rescheduling & Tax Opportunities

Rescheduling

- Would remove IRC 280E
- Effective Income Tax Rates Like Any Traditional Taxpayer
- Lessens the Cash Flow Burden
- Revise Cash/Tax Projections to Address
  - Expansion Opportunities
  - Investor Expectations
- Opens the Opportunity for Tax Strategies
  - Tax Credits
  - Deductions

Tax Opportunities - Deductions

Accelerated Depreciation

- Bonus Depreciation
- Section 179
- Cost Segregation Studies

179D Deduction

- Energy Efficient Establishments/Buildings/Facilities

Net Operating Losses

- Taxable Income Limitations

Pass-through Entity Tax

- State Tax Deduction

Tax Credits

Research and Development

- Federal and State
  - Dollar-for-dollar Tax Credit
  - Driven by Salaries, Development, and Contractor Expenditures
  - Design, Development, Improvement of Products and Processes are Key
  - Enhances Cash Flows
  - Available in Multiple States
    - AR, CA, CO, ME, MD, MA, NJ, NY, VT

Tax Credits

Investment Tax Credit
- Encourages taxpayers to invest in tangible property
- Credit is based on current year fixed asset additions.

Types of Credits
- Solar: A 30% Credit on Qualified Property. A 40% Credit in Some Cases.
- Hydro: Credits on Cultivation, Manufacturing, and Agricultural Facilities

Transferability of Credits

Poll Question 3

What would you do with extra cash flow?

Exit Considerations

Exit Considerations

Asset vs. Stock sales

Qualified small business stock

ESOP

Cannabis industry mergers and acquisitions take many shapes, sizes, and forms.

Selling Your Company -Things to Consider

Asset vs Stock Deal

- Nature of business assets may dictate the structure of the deal. Dispensary licenses and assets not deductible at Federal level.
- Business liabilities – stock deals will inherit the “sins” of the previous owners. (Think tax debts!)

Stay Compliant

- Maintain your good standing with the government.
- Put your best foot forward for potential buyers.

Selling Your Company – Asset Sales

Buyers Typically Like Asset Sales

- Step up in basis of assets (Might be a moot point for dispensaries.)
- Avoid “dirty laundry”

Not So Beneficial For Sellers

- Expect to pay more taxes. Gains that result from the sale of assets may be subject to ordinary income tax rates.
- Depending on structure, potential double taxation when getting money from the asset sale to the owners in a corporate structure.

Selling Your Company – Stock Sales

Sellers Typically Like Stock Sales

- Much Better Tax Advantages
  - Taxed as Capital Gains (more favorable rates)
  - Qualified Small Business Stock
  - Stock for Stock Deals (tax free)
- Not So Beneficial For Buyers
  - Acquire the sins of the past
  - No step up in depreciable assets

Qualified Small Business Stock (QSBS)

$10,000,000 Tax Exemption per Shareholder on Sale of QSBS

QSBS

Must be:

- Issued by a Domestic C-Corp
- S-Corporations **DO NOT** qualify
- Acquired at Original Issue and For Services Rendered or Capital Contributed
- Held for Five Years to Qualify for Exclusion
- Stock in **Qualified Small Business**

Qualified Small Business

Aggregate Gross Assets **cannot** exceed $50 million at issuance of stock.

80% of corp's assets are used in active conduct of qualified trade or business.

…For "**substantially all** of the shareholders' holding period"

Qualified Trade or Business

<u>Defines QTB by What It's **NOT**</u>

- **Specified Service Trade or Business**
  - Health, Law, Engineering, Architecture, Accounting, Actuarial Science, Performing Arts, Consulting, Athletics, Financial Brokers -- Principal Asset 'Reputation or Skills'
- **Financial Businesses**
  - Banking, Insurance, Financing, Leasing
- **Farming Businesses (Cannabis)**
- **Oil & Mining Businesses**
- **On-Premise Service Businesses**
  - Hotel, Motel, Restaurant, or Similar Business
- **Real Estate**

Tax Free Exchanges

Stock for Stock Deals

- Seller has no capital gains and maintains carryover basis.
- Common in the Earlier Days
  - Ways for MSOs to Enter New Markets
  - Cashless Transaction
- More Risk for the Seller
  - Stock in the new company can fluctuate rapidly

What is an ESOP?

Employee benefit plan that provides a company's workforce with an ownership interest in the company.

ESOP purchases the company from the current ownership.

Why an ESOP?

- 100% ESOP owned S Corp. is not subject to income tax.
- Sale of company stock can be tax exempt if QSBS or tax deferred if rolled into U.S. stock.
- Can get a second bite at the apple if the company is sold at a later date through issuance of warrants.

Poll Question 4

How likely are you to consider adopting an Employee Stock Ownership Plan (ESOP) for your cannabis business?

Questions

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