



Cannabis Entity Structures

Everything you need to structure your
cannabis business in the most efficient way

CANNABIS ENTITY STRUCTURES

Build A Business Ready for Growth

Choosing your cannabis business' entity structure is one of those small decisions that can ultimately have a major impact on the future of your business. Choose the right structure and gain tax, cash flow, and operational efficiencies that give you a competitive edge. Choose the wrong structure and you may expose yourself to double taxation and a variety of legal complexities down the road.

How do you choose the right entity structure?

There is no one-size-fits all answer to this question. It ultimately depends on the verticals you operate in, who owns the company, what market you operate in, and perhaps most importantly, what your long-term goals or exit plan is. You have to weigh your near-term needs with your long-term goals. The good news is, as your needs change, you'll have the option to update or alter your entity structure.

How does this guide help?

In this document you'll find two essential tools for helping you determine the best path forward. In the first section, we'll provide short definitions of the four most common entity choices. In the second section, we'll provide side-by-side comparisons so you can weigh the positives and negatives.

We Can Guide You

If you unsure about which structure to choose, reach out to us for a consultation and our tax and accounting experts will help.

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Intro to Entity Structures

LLCs and LLPs

This type of entity must register with the state, and then individual members are protected from liability as long as the cannabis company obeys state regulations.

Pros: There aren't as many formal restrictions on an LLP or LLC as with a registered corporation, and partners are not liable for the behavior of other partners.

Cons: members of the LLC must pay a self-employment tax for Medicare and Social Security.

C-Corporation

A common choice, in a C-Corp, the business is owned by individual shareholders who have stock in the company. Shareholders vote on how to run and grow the business, and a Board of Directors makes the final decision.

Pros: Shareholders are not personally responsible for debts and obligations of the company. Also, this structure opens the possibility for other funding options through stock and investment.

Cons: Entities face double taxation from business and personal income tax.

S-Corporation

The S-Corp is a tax election, meaning that a corporation, LLC, or LLP is created at the state level and then elects to be taxed under the S-Corps heading. These businesses can have no more than 100 shareholders and only one class of stock.

Pros: Avoid the double taxation as a C-Corps and attract investors as shareholders

Cons: Typically have higher legal and tax service costs, and shareholder growth is capped at 100.

General and Limited Partnerships

Two or more people are running the cannabis business and jointly share responsibility for the business's obligations.

Pros: Lower risk profile; the business's taxes are filed separately from the individuals.

Cons: The business' income – and loss – are passed through to the individual partners. The owners assume significant personal risk.

Entity Structure Comparison

	LLC	S-Corporation	C-Corporation	Partnership
Description	<p>An LLC can only be formed by making appropriate filing with the state (see below). Owners are called members and the LLC may be managed by the members, similar to a partnership, or by managers selected by the members, similar to a corporation. Treated as a partnership for tax purposes unless contrary election is made.</p>	<p>Non-tax formalities for formation are identical to C corporation (i.e., filing of articles of incorporation with the state). Assuming all the requirements for election are satisfied, shareholders are taxed instead of corporation. Income from business subject to single level of taxation.</p>	<p>A corporation is formed by making appropriate filing with the state (i.e., articles or certificate of incorporation). Absent an election by the shareholders be treated as S corporation, income from business may be subject to double taxation at entity level and again on distribution to the shareholders.</p>	<p>A general partnership may be formed without any governmental filing by oral or written agreement. Limited partnership can only be formed by making appropriate filing with the state (i.e., certificate of limited partnership). Partners are taxed instead of partnership. Income from business subject to single level of taxation. Limited partners have limited liability for debts of the business and income is not taxed at entity level.</p>
Liability for Entity Debts	<p>Members have limited liability for debts of the business.</p>	<p>Shareholders have limited liability for debts of the business.</p>	<p>Shareholders have limited liability for debts of the business.</p>	<p>General partners have unlimited liability for the debts of the business while limited partners have limited liability.</p>
Participation in Management	<p>Flexibly determined by members in operation agreement. Members can participate directly in management of the business or may elect to delegate authority to one or more managers.</p>	<p>See C corporation.</p>	<p>Directors and officers have responsibility for the management of the business; shareholders generally are not entitled to actively participate in management unless they are directors or officers or an election is made to operate as a statutory close corporation.</p>	<p>General partners have the exclusive right to manage the business; limited partners' rights are restricted to preserve limited liability.</p>
Transferability of Interests	<p>Securities law restrictions on transfer and restrictions may also be imposed in the operating agreement. A member may assign right to distributions, but the assignee can only become a member if other members consent as provided in operating agreement.</p>	<p>Securities law restrictions on transfer and restrictions may also be imposed in the shareholders agreement, if any. Shareholders may also agree not to make any transfers that would lead to termination of S corporation status.</p>	<p>Securities law restrictions on transfer and restrictions may also be imposed in a shareholders agreement, if any.</p>	<p>Securities law restrictions on transfer of limited partnership interests and restrictions may also be imposed in the partnership agreement. A partner may assign right to distributions, but the assignee can only become a partner if other partners consent as provided in the partnership agreement.</p>
Ability to Raise Capital	<p>Good if there is no intention to go public. Venture capitalists are still unlikely to invest in non-corporate entities; however, an LLC can be easily converted into C-corporation to admit investors if necessary.</p>	<p>Very limited</p> <ul style="list-style-type: none"> • 75 shareholders maximum • one class of stock • U.S. individuals only 	<p>Best if public offering or venture capital funding is planned; however, an LLC can easily convert into C corporation.</p>	<p>Equity capital for general partnership is limited to contributions from the active general partners. As for limited partnerships, see LLC.</p>

Entity Structure Comparison

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Preferences Among Owners	Substantial flexibility to create preferences with respect to distributions and allocations in the operating agreement; however, allocations must have "substantial economic effect."	Very limited due to inability to create more than one class of stock.	Substantial flexibility through use of various classes and series of preferred stock.	Substantial flexibility to create preferences with respect to distributions and allocations in the partnership agreement; however, allocations must have "substantial economic effect."
Term	Determined by operating agreement.	Perpetual.	Perpetual.	Determined by partnership agreement.
Entity Level Federal Income Taxes	No federal tax at LLC level unless LLC elects to be taxed as corporation.	Generally no tax at S corporation level; some excise taxes, and built in gains taxes may apply.	Income tax on earnings at corporate level.	No federal tax at partnership level.
Number of Required Owners	Most states now allow an LLC to be formed with any number of members, including just one member.	No more than 75.	Any number.	At least two.
Eligibility Requirements of Owners	No restrictions.	US citizens or resident individuals, certain trusts, and certain tax exempt entities.	No restrictions.	No restrictions.
Entity Level State Taxes	States often impose business and occupation tax on gross proceeds or gross income or charge a minimum annual fee to maintain good standing of the entity. Check specific requirements.	As at federal level, generally no tax at S corporation level; some states do impose a corporate level tax on S corporations at lower rates than that imposed on C corporations.	Generally income is taxed at corporate level; however a number of states have eliminated corporate income taxes or charge substantially reduced rates.	See LLC.
Tax on Distributions of Appreciated Property	Generally, no tax to either LLC or member (certain exceptions apply).	Taxable gain on distribution passed through to shareholders.	Taxable gain to corporation and dividend to shareholders.	Generally, no tax to either partnership or partner (certain exceptions apply).
Special Allocations of Income or Deduction	Allowed, subject to substantial economic effect rules.	Not allowed – all allocations are pro rata.	Not allowed.	Allowed, subject to substantial economic effect rules.
Distribution Preferences	Allowed.	Not allowed – one class of stock requirement.	Preferred stock allowed.	Allowed.
Deductibility of Losses by Owners	Members may deduct their shares of losses to extent of basis, which includes LLC level debt (certain other limitations apply).	Shareholders may deduct their shares of losses to extent of basis, which does not include corporate level debt.	No deduction at shareholder level.	Partners may deduct their shares of losses to extent of basis, which includes partnership level debt (certain other limitations apply).
Fiscal year	Generally calendar.	Generally calendar.	No restrictions.	Generally calendar.
Status of Owner/ Employment	Not clear, but more likely treated as self-employed.	If ownership interest is greater than 2%, then treated as self-employed.	Treated as employees; therefore entitled to \$105 (accident and health) \$101 (death benefits) \$125 (cafeteria plans) \$119 (meals/lodging).	Self-employed.

Entity Structure Comparison

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Self Employment and Social Security Taxes	Earnings generally subject to self employment taxes, except for earnings from passive investment type interests.	Social security taxes imposed on wages of employee- owners/no self employment tax on distributions.	Social security taxes imposed on wages of employee- owners/no self employment tax on distributions.	Earnings generally subject to self employment taxes, except for earnings attributable to limited partnership interests.
Non-Taxable Fringe Benefits (group health insurance, accident or health benefits, meals or lodging, cafeteria plan benefits)	Cash value of fringe benefits generally not excludable from member's income or deductible by LLC.	Cash value of fringe benefits generally not excludable from shareholder- employee's income or deductible by S corporation.	Deductible by corporation – not included in income of shareholder- employee.	Cash value of fringe benefits generally not excludable from partner's income or deductible by partnership.
Option Plans, NSO's, ISO's	Employees & consultants can be given options to acquire LLC interests, but such options are generally more complex. ISO's not available.	ISO's commonly granted to employees. NSO's may be granted to consultants and advisors.	ISO's commonly granted to employees. NSO's may be granted to consultants and advisors.	Employees & consultants can be given options to acquire partnership interests, but such options are generally more complex. ISO's not available.
Adjustments to Basis on Death of Owner	Inside basis may be adjusted on death or transfer under Code §754.	No Code §754 adjustments to basis.	No Code §754 adjustments to basis.	Inside basis may be adjusted on death or transfer under Code §754.
Termination on Transfer of Interests	LLC terminates for tax purposes on transfer of 50% or more of capital and profits in 12 months.	No termination of entity on transfer of interests.	No termination of entity on transfer of interests.	Partnership terminates for tax purposes on transfer of 50% or more of capital and profits in 12 months.
Increase in Basis for Debt	Members increase outside basis by share of LLC debt.	No increase in basis in stock for corporate level debt.	No increase in basis in stock for corporate level debt.	Partners increase outside basis by share of partnership debt.
Treatment of Foreign Owners	Foreign members subject to US tax on their share of LLC's effectively connected income; branch profits tax may apply.	Foreigners cannot be shareholders of S corporation.	Foreigners are subject to withholding tax on dividends from US corporation, subject to treaty rate or exemption.	Foreign partners subject to US tax on their share of partnership's effectively connected income; branch profits tax may apply.
Foreign Individual Owners – Transfer Taxes	Membership interest may be subject to US estate and gift taxes.	N/A. Foreigners cannot be shareholders of S corporation.	Corporate stock is not US situs asset for gift tax purposes.	Partnership interest maybe subject to US estate and gift taxes.
Conversion to Another Entity	Generally may be incorporated (by conversion or otherwise) tax free (certain exceptions apply).	Can convert to C corporation by revoking election; may be tax on converting to LLC.	Can convert to S corporation by making election (built in gains tax may apply to later dispositions of appreciated property). Conversion to LLC may be taxable.	Easily converted to LLC or generally may be incorporated tax free (certain exceptions apply).
Taxes on Sale or Liquidation	One level of tax on sale of stock or assets, generally capital gain except for amount allocable to certain assets.	One level of tax on sale of stock or assets, generally capital gain on stock sale.	Potential double tax. Corporate tax on sale of assets. Shareholder level tax on sale of stock or liquidation.	One level of tax on sale of stock or assets, generally capital gain except for amount allocable to certain assets.

Entity Structure Comparison

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Exit Strategy	Superior for: (a) asset sales – gains subject to single tax; (b) liquidation – not a taxable event. NOTE: Easy to convert from LLC to C corporation- difficult to go the other way.	See C corporation.	Superior for: (a) public offering but can start as LLC and convert later (however, may be taxable); (b) stock sale may be eligible for §1202 treatment; (c) tax-free reorganization (e.g., merger).	See LLC.
Ease and Expense of Organization	Can be relatively high if many members and preferences. Requires more tax planning.	Medium.	Medium, unless preferred stock in which case expenses can increase.	See LLC.
Governing Tax Statute	IRC subchapter K.	IRC subchapter S.	IRC subchapter C.	IRC subchapter K.
Documents (not including purchase documents)	Certificate of Formation or Articles of Organization; Operating Agreement; Form SS-4 (optional for single member).	See C corporation. Also Form 2553.	Articles or Certificate of Incorporation; Bylaws; Shareholder Agreement; Stock Certificates; Form SS-4.	Certificate of Limited Partnership; Partnership Agreement; Form SS-4.

CANNABIS ENTITY STRUCTURES

Create a Foundation for Success

Our goal is to empower your growth and protect your revenue. If you need any assistance with choosing or implementing an entity structure or assessing the impact of entity structure on an M&A deal, capital raise, or go-public transaction, we can help. Just reach out to us to schedule a consultation.

About GreenGrowth CPAs

As the leading cannabis accounting and advisory firm, we've successfully supported hundreds of cannabis operations, filed thousands of tax returns, and supported IPOs/RTOS. We offer a complete suite of business solutions: including audit and assurance, tax planning and compliance, accounting and financial support, and advisory services.

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