October 21, 2024

The Honorable Janet Yellen
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Daniel Werfel
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Guidance Requested for Cannabis Businesses Transitioning Away From Application of Section 280E

Dear Secretary Yellen and Commissioner Werfel,

The American Institute of CPAs (AICPA) is writing to express our concern over IR-2024-177 that was published on June 28, 2024, in which taxpayers were notified taxpayers that cannabis remains a Schedule I controlled substance and, therefore, section[1] 280E remains applicable. On May 21, 2024, the Department of Justice issued proposed regulations that would reschedule marijuana from a Schedule I controlled substance to a Schedule III controlled substance.[2] We urge the Department of Treasury ("Treasury") and the Internal Revenue Service (IRS) to provide much-needed guidance to cannabis businesses in advance of the impending transition away from engaging in a trade or business that subjects them to section 280E.

Although there are many outstanding tax issues for cannabis businesses, we provide the following recommendations as a starting point for issuing guidance to cannabis businesses and tax practitioners as soon as possible in anticipation of potential rescheduling of marijuana as a controlled substance. We look forward to working with you on these issues and others to ensure that taxpayers are encouraged to comply with the law and that tax professionals are able to provide advice and services to cannabis businesses.

I. Retroactive Treatment for Expenses Previously Subject to Section 280E

Overview

Section 280E disallows deductions or credits for amounts paid or incurred during the taxable year if a business consists of trafficking in controlled substances (*within the meaning of Schedule I and II of the Controlled Substances Act*).[3] The main issue confronting cannabis businesses and tax professionals is a midyear change in the application of section 280E (i.e., a cannabis business's expenses not being deductible for part of the year, but allowed as a deduction for the remainder of the year once no longer subject to section 280E). In anticipation of marijuana rescheduling, cannabis businesses will need to begin tax planning (e.g., they may delay either making or incurring vendor payments in order to maximize deductibility of such

[1] Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.
[2] *See* Docket No. DEA-1362, 89 Fed. Reg. 44,597 (May 21, 2024).
[3] 21 U.S.C. §812.

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expenses, delay equipment purchasing, prematurely filing returns assuming that marijuana will be rescheduled imminently) and taking tax positions without the benefit of IRS guidance. This type of mid-year change in the application of section 280E will create artificial behaviors, produce uncertainty and unnecessary risk, and have a myriad of tax accounting consequences.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance providing that cannabis businesses are permitted to take deductions for the full tax year in the year in which marijuana is rescheduled to a Schedule III controlled substance and, therefore, cannabis businesses are no longer subject to 280E for that entire year and future years.

Analysis

For the tax year in which marijuana is rescheduled as a Schedule III controlled substance, cannabis businesses should be permitted to take business deductions for the full tax year, including deductions arising from expenses incurred between the beginning of the cannabis businesses' tax year and the effective date of the final regulation rescheduling marijuana. This approach provides taxpayers simplicity and certainty, two of the AICPA guiding principles of good tax policy.

Example

A cannabis business ("Business") incurs $200,000 of expenses during the first three quarters of 2024 that are non-deductible as a result of section 280E (e.g., rent, fees for professional services, payroll taxes, etc.). On October 1, 2024, the Department of Justice issues a final regulation rescheduling marijuana as a Schedule III substance, effective on that date. Business incurs $100,000 of expenses that would have been non-deductible pre-October 1, 2024 during the fourth quarter of 2024. Business should be permitted to deduct all $300,000 of those expenses for the tax year in which section 280E started to no longer apply thereto, rather than merely the $100,000 following the effective date of the rescheduling.

Implementing accounting changes to a business in the middle of its tax year has the potential to cause significant compliance issues, which leads to confusion, unnecessary complexity, and increased tax administration expenses. By allowing cannabis businesses to claim deductions for the full tax year, they will be afforded a clear timeline for adjusting accounting practices and implementing new tax planning measures. This approach ensures consistency and fairness in tax treatment throughout the business's entire tax year. Furthermore, this approach is consistent with how states have historically implemented similar changes, providing a stable and predictable regulatory environment.

Treasury has the authority to provide guidance to clarify that once the final rule rescheduling marijuana as a Schedule III controlled substance is published, all expenditures for that tax year for the taxpayer will be treated similarly without the application of section 280E. This result is reasonable and provides taxpayers with certainty while operating their businesses while the potential for rescheduling moves forward. Furthermore, affording cannabis businesses

transitional relief to claim all deductions for the full tax year in the year in which marijuana is rescheduled clearly aligns with the goal of establishing equitable and fair tax policy.

II. Clarify Issues Stemming from Prior Section 280E Disallowance

Overview

Upon the rescheduling of marijuana as a Schedule III controlled substance, existing cannabis businesses will encounter many tax and accounting issues when transitioning from the application of section 280E to no longer being subject to section 280E.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance clarifying the tax treatment of issues arising from no longer being subject to section 280E, including accounting year changes, partnership basis, and depreciation.

Analysis

Certain tax credits and deductions would be available for the first time to cannabis businesses when marijuana is rescheduled as a Schedule III controlled substance. Because cannabis businesses will need to consider such tax credits and deductions for the first time, they should be permitted to reconsider their existing accounting method and be afforded flexibility to adopt a new accounting method. Additionally, cannabis businesses should be afforded the same opportunity to reconsider their inventory accounting method and potentially adopt a new method.

Cannabis companies may incur years of expenses prior to obtaining a cannabis license. Costs may have been incurred in years prior to rescheduling and may continue through and after rescheduling. Additionally, cannabis companies organized as partnerships for tax purposes reduce their basis in membership interests by nondeductible costs. It is important to determine the point at which these costs would be applicable to either be properly capitalized as start-up costs or added to the basis of membership interests upon a sale or transaction, as disparity in practice will ensue. Thus, cannabis businesses will need transitional guidance on the application of costs that were previously nondeductible under section 280E with regard to basis in future transactions, as well as clear guidance on the period of time for which they can address such basis issues.

We suggest that Treasury and the IRS also consider issuing guidance on any other issues that may impact cannabis businesses transitioning away from the application of section 280E, such as recapture depreciation for assets placed into service before the effective date for rescheduling, the period of time to retroactively catch up on depreciation, the amortization period for intellectual property purchased before the effective date for rescheduling, the qualified business income deduction, and eligibility to claim research and development credits for qualifying research and development expenses (both during the tax year in which rescheduling occurs and for prior tax years in which businesses began incurring research and development expenses).

By providing guidance in advance of marijuana rescheduling that addresses cannabis business issues in a post-section 280E tax regime, Treasury and the IRS would have ample time to provide fair and adequately tailored transitional relief, would allow tax practitioners providing accounting services to cannabis businesses to take reliable and reasoned tax positions, and would ease the expense and time required to adopt appropriate tax and accounting practices in light of the transition away from section 280E.

III. Uniform Tax Treatment Among Cannabis Businesses

Overview

States have adopted differing approaches on the legalization of marijuana, the types of permissible marijuana use, and taxation of cannabis businesses. If marijuana is rescheduled as a Schedule III controlled substance, application of section 280E to cannabis businesses should be consistent for all such businesses legally operating within their states.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance ensuring that upon the rescheduling of marijuana as a Schedule III controlled substance, section 280E apply equally to all cannabis businesses legally operating within their respective states, regardless of whether they sell medical marijuana or recreational marijuana.

Analysis

The Department of Justice issued proposed regulations rescheduling the following as a Schedule III controlled substance: (i) marijuana; (ii) marijuana extract; and (iii) naturally derived delta-9-tetrahydrocannabinols (THC). The proposed regulations do not differentiate between medical and recreational marijuana. Upon publication of the final regulations, section 280E would not apply to any cannabis business engaged in the production or sale of the three categories listed in the regulations, provided that the business activity is legal pursuant to state law. Although there would be no basis to treat cannabis businesses differently under section 280E, any differentiation under section 280E between medical and recreational cannabis providers would unnecessarily complicate the tracking of expenses and compliance efforts for businesses.

Although the three categories (i.e., marijuana, marijuana extract, and naturally derived THC) would no longer fall under section 280E, there are businesses that produce and/or sell products mimicking marijuana, such as synthetically derived cannabinoids. The Department of Justice has not proposed rescheduling synthetically derived cannabinoids. Thus, any guidance clarifying the impact of the proposed rescheduling would need to distinguish between (i) engaging in the production or sale of the substances proposed to be rescheduled, and (ii) engaging in the production or sale of substances that were not rescheduled but may be mistaken as falling within the same category as the rescheduled substances. Furthermore, such guidance may need to address the applicability of section 280E to businesses that engage in the production or sale of marijuana, marijuana extract, and naturally derived THC, as well as synthetically derived cannabinoids.

IV. Volunteer Disclosure Program

Overview

Some cannabis businesses may have claimed deductions in prior years under the belief that section 280E did not apply.

Recommendation

The AICPA recommends that Treasury and the IRS offer a voluntary disclosure program for cannabis businesses that would no longer be subject to section 280E as a result of the rescheduling of marijuana.

Analysis

Although cannabis businesses may have unintentionally claimed deductions limited by section 280E, others may have claimed such deductions in anticipation of the rescheduling of marijuana as a Schedule III controlled substance. A voluntary disclosure program targeting cannabis businesses would allow cannabis businesses not in compliance the opportunity to correct such issues and to have a fresh start under a tax system with greater clarity and guidance than when they were subject to section 280E.

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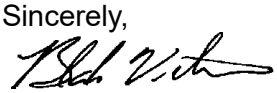
We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact; Daniel Hauffe, AICPA Senior Manager, Tax Policy & Advocacy at (202) 434-9260 or Daniel.Hauffe@aicpa-cima.com; Dana McCartney, chair of the AICPA Individual and Self-Employed Tax Technical Resource Panel at (512) 370-3275 dmccartney@mlrpc.com; or me at (830) 372-9692 or Bvickers@alamo-group.com.

Sincerely,



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