Massachusetts May "Decouple" From Section 280E

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Key Takeaways:

- Massachusetts is on the brink of becoming the next member of a growing number of states that are "decoupling" from Section 280E, the federal tax law that severely limits the extent to which cannabis-related businesses can deduct expenses for income tax purposes.
- If pending legislation is enacted, such limitations would not apply for Massachusetts state income tax purposes, leading to potential tax relief for Massachusetts cannabis-related businesses.

Section 280E of the Internal Revenue Code provides that no deduction or credit shall be allowed for any amount paid or incurred in carrying on any trade or business if such trade or business consists of trafficking in controlled substances listed on Schedule I or II of the federal Controlled Substances Act.[1] Cannabis currently is listed as a "Schedule I" controlled substance for this purpose. Accordingly, cannabis-related businesses have been (and remain) subject to Section 280E. Many states, including Massachusetts, use a taxpayer's federal taxable income as the starting point for calculating state taxable income. Accordingly, the effects of Section 280E have carried over to Massachusetts and, effectively, have prevented Massachusetts cannabis businesses from deducting their ordinary and necessary business expenses from taxable income for federal and Massachusetts income tax purposes (except to the extent that any such expenses can be claimed as "cost of goods sold," which generally is much more limited in scope). As noted above, the pending legislation would remove (or "decouple") Massachusetts from Section 280E for state income tax purposes.

Specifically, the proposed Massachusetts law provides that, for purposes of determining taxable income for Massachusetts income tax purposes, a cannabis-related business that is subject to Section 280E for federal income tax purposes would be permitted to deduct ordinary and necessary business expenses paid or incurred during a taxable year that are non-deductible at the federal level due to Section 280E. If enacted in its current form, the new law would be effective for taxable years beginning on or after January 1, 2022. Accordingly, cannabis-related businesses could benefit from this change retroactively.

Businesses already operating in Massachusetts stand to benefit, while others considering a new or increased presence in Massachusetts may consider moving certain business functions and activities to the Bay State (although that decision would depend on all relevant facts and circumstances, including general business considerations, as well as the net effect of a reduced tax base being exposed to Massachusetts' relatively high 8% corporate income tax rate). Cannabis-related businesses may have similar considerations with respect to new or increased operations in other states that have "decoupled" from Section 280E, including California, Colorado, Hawaii, Michigan, New York and Oregon.

We are closely monitoring this new development in Massachusetts and all other states. Please contact a member of Foley Hoag's Cannabis Practice Group if you would like assistance in determining the effect of Section 280E "decoupling" with respect to your business in Massachusetts and elsewhere.

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[1] 21 U.S.C. § 801, *et seq.*

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