



280E EXPLAINED

A plain-English brief for state-legal cannabis operators, executives, lenders, and advisory clients.

What operators need to understand now

Section 280E does not let marijuana businesses deduct most ordinary business expenses for federal income tax purposes, even when those businesses are fully licensed under state law.

That means a company can look modestly profitable on its books - or even break even on cash flow - and still owe tax on income measured largely before payroll, rent, marketing, software, and other operating costs.

As of April 2026, the federal rescheduling process has not been finalized, so 280E remains a live planning issue for marijuana operators.

Three takeaways for management teams

1. Gross margin becomes strategy

Because COGS is the one major cost category that still reduces taxable income, product mix, purchasing discipline, shrink control, and production efficiency matter even more.

2. Clean records are not optional

Inventory methods, support for direct costs, and consistent books by entity and activity are the backbone of a defensible 280E position.

3. Cash planning must start early

Waiting until return time is too late. Operators should model tax exposure monthly and carry 280E into pricing, budgeting, and financing decisions.

Prepared by Grown In for operator education and strategic planning. This brief is not legal or tax advice; specific treatment depends on facts, accounting method, structure, and documentation.

How 280E works in practice

In plain terms, the rule creates a mismatch between **book profit** and **taxable income**. For many operators, the tax base ends up much closer to gross margin than to net income.

<p style="text-align: center;">Gross receipts Top-line sales from retail, wholesale, or production activity.</p>
<p style="text-align: center;">Minus COGS Inventory acquisition and certain direct production costs reduce gross receipts before 280E applies.</p>
<p style="text-align: center;">Equals gross income This is the line where many marijuana operators begin their federal tax problem.</p>
<p style="text-align: center;">Most ordinary deductions and credits are disallowed Payroll, rent, sales labor, marketing, software, and other operating costs often still hit cash - but generally do not reduce federal taxable income.</p>

Simplified planning lens

<p>Costs that often matter for COGS or inventory support</p> <ul style="list-style-type: none">• Purchase price of inventory.• Direct labor and direct materials tied to production.• Packaging or processing costs directly connected to inventory.• Certain production-facility costs allocable to inventory under applicable rules.	<p>Costs operators often expect to deduct - but 280E can block</p> <ul style="list-style-type: none">• General administrative payroll and executive overhead.• Retail sales-floor labor and many store operating costs.• Marketing, advertising, and business development expense.• Compliance, software, office expense, and many professional fees.
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Important: these categories are simplified for education. Exact treatment depends on operator type, accounting method, contemporaneous records, and whether a cost is truly inventoriable or instead a general business expense.

Operator examples

The matrix below uses a flat **30% illustrative tax rate** to show how federal tax can diverge from operating reality. The goal is to show the shape of the issue, not provide return-ready calculations.

Metric	Single-state dispensary Retail-heavy; thin net margin	Cultivator / manufacturer Better COGS depth; SG&A still matters	Vertically integrated operator Scale helps; mismatch remains
Revenue	\$8.0M	\$7.5M	\$15.0M
COGS	\$5.2M	\$4.9M	\$9.7M
Operating expense not reducing federal taxable income	\$2.1M	\$1.3M	\$3.9M
Book operating profit	\$0.7M	\$1.3M	\$1.4M
280E taxable income	\$2.8M	\$2.6M	\$5.3M
Illustrative tax at 30%	\$0.84M	\$0.78M	\$1.59M
What management should take from it	Tax can exceed book profit. Margin discipline and cash reserves matter.	Direct-cost support matters, but SG&A still drives the mismatch.	Scale without segment reporting and forecasting can magnify exposure.

Reading the table: revenue minus COGS may leave a taxable-income number that bears little resemblance to what management thinks of as operating profit. That is the 280E problem in one page.

What disciplined operators do next

280E is not only a tax issue. It affects pricing, staffing, capital planning, investor communication, and how management interprets real operating performance.

Management checklist

- Model tax exposure monthly, not only at year-end.
- Tie inventory movements to clean source documentation.
- Review gross margin by product, channel, and facility.
- Separate direct production activity from general overhead in the books.
- Stress-test liquidity using tax payments as a fixed cash-use line item.

Questions worth asking advisors

- Are our COGS assumptions consistent with our method and support?
- Do entity books, payroll mapping, and intercompany agreements match how the business actually operates?
- Are we telling lenders and investors a realistic post-tax cash story?
- Where are we taking positions that would be hard to defend in an exam?
- How would our planning change if federal reform or rescheduling eventually becomes final?

How Grown In can frame the issue

Grown In helps operators turn 280E from a vague tax burden into an operating decision set: margin strategy, reporting discipline, scenario planning, and a clearer management narrative for partners, boards, lenders, and investors.

For advisory support or a tailored version of this explainer, contact contact@grownin.com or visit grownin.com

Primary source notes

- 26 U.S.C. Section 280E.
- IRS Chief Counsel Memorandum 201504011 (Jan. 23, 2015) regarding COGS and inventory methods.
- IRS Taxpayer Advocate Service overview of marijuana-related federal tax issues (May 10, 2022).
- U.S. Department of Justice proposed rule to move marijuana to Schedule III (May 16, 2024).
- DEA notice postponing the marijuana rescheduling hearing (Jan. 15, 2025).

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