

# Legal Literacy Tip Sheet for Cannabis Entrepreneurs

## Choosing A Business Structure

Cannabis businesses face unique challenges. As a social equity entrepreneur preparing to own or operate a cannabis business, choosing the right business entity is vital — it can impact your liability, taxes, and daily operations.

Take the time to understand your options to protect yourself, stay in control, and set your business up for sustainable success.

### WHY ENTITY CHOICE MATTERS

- **Liability Protection:** Protect your personal assets from business risk
- **Tax Efficiency:** Impacts how much you pay in taxes
- **Costs:** Ranges from low setup costs to ongoing fees
- **Control:** Impacts who decides and shares profits
- **Access to Funding:** Some entities attract investors
- **Compliance:** Must align with license requirements
- **Growth & Exit:** Affects expansion or future sale

### COMMON TYPES OF ENTITY

- **Sole Proprietorship:** One Owner; no liability protection
- **General Partnership:** Two or more owners; shared control, full liability
- **Limited Partnership:** General partner (full liability) and limited partner
- **Limited Liability Company (LLC):** Flexible structure; protects owners from personal liability
- **C- Corp:** Separate legal entity; liability protection, subject to double taxation
- **S- Corp:** Liability protection; profits and losses pass through to owners

### CANNABIS BUSINESS STRUCTURE CHALLENGES



#### Federally Illegal

Restricts financial access and influences taxes and risk.



#### 280E Tax Restrictions

You can't deduct most business expenses.



#### Licensing Complexities

Your business entity must comply with strict licensing requirements.

### 280E: THE CANNABIS TAX RULE YOU CAN'T IGNORE

IRS Section 280E is a federal tax provision that prohibits deductions or credits for any business trafficking a Schedule I or II substance, like cannabis — even if it's legal under state law.

- **Allowed:** Only Cost of Goods Sold (COGS)
- **Not Allowed:** Typical business expenses (e.g., rent, salaries, utilities)

**Impact:** Cannabis businesses pay higher taxes because they cannot deduct most expenses.



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ENTITY TYPES AT A GLANCE			
ENTITY	HOW TO FILE	TAX	LIABILITY
<b>SOLE PROPRIETORSHIP</b>	No formal paperwork needed	Owner taxed personally; pass-through	Owner personally liable
<b>GENERAL PARTNERSHIP</b>	Informal agreement needed; written agreement recommended	Partners taxed personally; pass-through	Partners personally liable; Jointly and separately responsible.
<b>LIMITED PARTNERSHIP</b>	File Certificate of Limited Partnership with Secretary of State	Pass-through taxation	General partners personally liable; limited partners have liability protection
<b>LIMITED LIABILITY COMPANY (LLC)</b>	File Articles of Organization with Secretary of State*	Pass-through taxation	Limited liability protection
<b>S-CORP</b>	File Articles of Incorporation with Secretary of State*; elect S-Corp status with IRS	Pass-through taxation	Limited liability protection
<b>C-CORP</b>	File Articles of Incorporation with Secretary of State*	Subject to corporate tax	Limited liability protection

\*California Secretary of State Website: <https://bizfileonline.sos.ca.gov/>

## BEFORE FILING FOR A BUSINESS ENTITY, ASK YOURSELF:

- What are the tax implications?
- What are the startup and ongoing costs?
- Does the business entity ensure majority ownership?
- Which entity offers the strongest liability protection?
- What are the governance requirements?

**GET TRUSTED HELP:**  
Always consult legal and financial advisors familiar with cannabis entities.

## KEY TAKEAWAYS

- ✓ **Liability:** LLCs and corporations help shield personal assets
- ✓ **Taxes:** Consider pass-through vs. double taxation (C-Corp); all cannabis entities face 280E limits
- ✓ **Protect Your Equity:** Ensure your 51% ownership and control are maintained; LLCs and corporations are common choices
- ✓ **Complexity & Growth:** Corporations require more governance, but offer better access to investors and scalability