

280E, insolvency and the inevitable structural failure of the cannabis economy

2026 PRINDBRF 0204 • By Richard P. Ormond, Esq., Buchalter LLP

Practitioner Insights Commentaries • May 06, 2026

(May 06, 2026) - Richard P. Ormond of Buchalter LLP examines how [Internal Revenue Code §280E](#) functions as an insolvency trigger for cannabis businesses and why federal rescheduling could transform the industry's financial viability.

Among all the legal distortions produced by federal cannabis prohibition, none has been more destructive, or more poorly understood by courts and policymakers, than [Internal Revenue Code §280E](#).

While criminal enforcement has ebbed and flowed, and while states have constructed elaborate regulatory regimes, [§280E](#) has functioned as a powerful accelerator of insolvency across the cannabis industry. It has distorted balance sheets, forced irrational capital structures, and rendered businesses unrecoverable.

The Trump administration's endorsement of federal rescheduling places [§280E](#) at the center of the reform debate, not as a tax technicality, but as an insolvency trigger.

This article examines how [§280E](#) operates as a federal penalty regime, how it collides with bankruptcy and receivership law, and why rescheduling, without any amendment to the Bankruptcy Code, would immediately and materially change the fate of distressed cannabis enterprises.

The origins and mechanics of Section 280E

[Section 280E](#) was enacted in 1982, long before the modern cannabis industry existed. Congress adopted the provision in response to a tax court decision that allowed a convicted drug trafficker to deduct ordinary business expenses.

The statute provides, in simple terms, that no deduction or credit shall be allowed for any amount paid or incurred in carrying on a trade or business that consists of trafficking in controlled substances prohibited by federal or state law.

The key word is trafficking. Under federal law, marijuana's classification as a Schedule I substance means that any commercial cannabis activity, no matter how comprehensively licensed by a state,

THOMSON REUTERS

WESTLAW TODAY

As a result, cannabis businesses are denied deductions for rent, payroll, insurance, utilities, marketing, professional fees, interest, and depreciation. Only cost of goods sold (cogs), which is treated as an adjustment to gross income rather than a deduction, remains available.

This structure produces a financial absurdity. Cannabis businesses are taxed not on net income, but on a fictional gross margin that bears little relationship to actual profitability. Effective tax rates routinely exceed 70 percent and, in loss years, can exceed 100 percent of cash flow. The tax obligation exists regardless of whether the business is solvent or not.

280E as an insolvency engine

In traditional industries, insolvency arises from a mismatch between revenues, expenses, and capital structure. [Section 280E](#) introduces a fundamentally different dynamic: it converts ordinary operating expenses into non-deductible losses while preserving full tax liability. As a result, cannabis companies often appear "profitable" for tax purposes at the precise moment they are actually failing.

This disconnect has severe multiplier effects. Tax liabilities accumulate rapidly. Businesses defer payments to taxing authorities to preserve liquidity, triggering penalties and interest that compound the problem. Lenders, aware that free cash flow is structurally impaired, demand higher interest rates, equity kickers, or collateral positions that would be unacceptable in other industries. The result is a sector characterized by thin capitalization, expensive debt, and chronic tax arrearages.

[Section 280E](#) does not merely increase tax burdens; it reshapes capital formation. Investors price in the tax penalty as a permanent feature, while management teams make operational decisions designed to manipulate cost of goods sold rather than optimize efficiency. The statute thus becomes a primary driver of insolvency.

Collision with bankruptcy law

When cannabis businesses inevitably fail, [§280E](#) follows them into insolvency proceedings. Bankruptcy law, however, is ill-equipped to accommodate an enterprise whose primary liabilities arise from a tax regime premised on ongoing criminality. And these businesses are denied passage into bankruptcy court.

Federal bankruptcy courts have consistently held that they cannot administer estates whose income or assets derive from federally illegal activity. Trustees cannot lawfully operate the business, sell marijuana inventory, or distribute proceeds derived from such sales. The presence of [§280E](#) liabilities only deepens the problem, as post-petition tax obligations continue to accrue.

THOMSON REUTERS

WESTLAW TODAY

Even if a court were inclined to permit a bankruptcy case to proceed, the economics of [§280E](#) make reorganization nearly impossible. A debtor cannot service secured debt, administrative expenses, and priority tax claims when a substantial portion of revenue is siphoned off through nondeductible taxation.

Receivership as a second-best alternative

State court receiverships have emerged as a partial workaround, not because they solve the [§280E](#) problem, but because they allow courts to manage the collapse outside the federal system. Receivers can operate under state licenses, preserve enterprise value, and attempt orderly sales.

Yet [§280E](#) remains omnipresent. Receivers inherit tax arrears that distort valuations, complicate sales, and deter buyers. Purchasers discount assets to account for future tax exposure, depressing recoveries for creditors.

Moreover, receivership does not eliminate federal risk. Civil asset forfeiture statutes remain available, and banking access remains constrained. Receivers often must operate on a cash basis, increasing security risks and administrative inefficiency. [Section 280E](#) thus continues to undermine outcomes even in forums designed to mitigate federal conflict.

Why rescheduling changes everything (hopefully ...)

The Trump administration's rescheduling initiative targets this structural failure directly, even if implicitly. [Section 280E](#) applies only to businesses trafficking in Schedule I or Schedule II substances. A move to Schedule III would remove cannabis entirely from [§280E](#)'s scope without a single word of tax legislation.

The consequences would be immediate and profound. Cannabis businesses would be taxed like ordinary enterprises. Losses would be real losses. Cash flow would align with taxable income. Historical tax liabilities would remain, but future operations would no longer generate artificial insolvency.

From an insolvency perspective, this change is transformative. Bankruptcy feasibility analyses would shift overnight. Credit markets would reprice risk downward, reducing the cost of capital across the sector. Tax law would cease to function as an enforcement proxy for drug policy.

Rescheduling is not a panacea. It will not erase legacy tax debts, will not automatically grant access to bankruptcy court, cure poor management, or retroactively validate failed business models.

Nor will it eliminate regulatory risk. Cannabis businesses would remain subject to intense federal oversight, including potential FDA and DEA regulation. Interstate commerce would remain constrained absent further legislative action.

But rescheduling would eliminate the single most corrosive force in cannabis insolvency: the structural impossibility of financial rehabilitation under [§280E](#).

Conclusion

[Section 280E](#) has done more to bankrupt cannabis businesses than raids, prosecutions, or licensing disputes. It operates quietly, relentlessly, and without regard to economic substance.

For years, courts and policymakers have treated cannabis insolvency as a moral or criminal issue rather than a structural one. This new rescheduling initiative reframes the problem and eliminates the [§280E](#) hurdles.

By removing cannabis from [§280E](#)'s reach, rescheduling would not merely reduce taxes. It would reintroduce the possibility of solvency, reorganization, and rational creditor outcomes. In that sense, rescheduling is less about cannabis than about restoring the integrity of federal tax and restructuring itself.

By Richard P. Ormond, Esq., Buchalter LLP

Richard P. Ormond is a partner at **Buchalter LLP**. He advises on bank and finance law, real estate, receivership law, banking regulations and restructuring. He is based in Los Angeles and can be reached at rormond@buchalter.com. This article was originally published April 23, 2026, on the firm's website. Republished with permission.

THOMSON REUTERS

WESTLAW TODAY



Richard P. Ormond

END OF DOCUMENT© 2026 THOMSON REUTERS. NO CLAIM TO ORIGINAL U.S. GOVERNMENT WORKS.

Trending **organizations**

[UNITED STATES, GOVERNMENT OF](#)[US SUPREME COURT](#)[NOVO HOLDINGS A/S](#)[ALPHABET INC.](#)[TESLA, INC.](#)

Trending **law firms**

[MORGAN LEWIS AND BOCKIUS LLP](#)[Brisbois Bisgaard & Smith LLP](#)[Vedder Price](#)[Jackson Lewis](#)[Sebolt & Wernow Co.](#)[Contact us](#)[Training and support](#)[Terms of use](#)[Full Desktop](#)

1-800-WESTLAW (1-800-937-8529)

THOMSON REUTERS
WESTLAW TODAY
[Accessibility](#)

[Privacy](#)

