

eBook

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CANNABIS INDUSTRY:

5 Steps to overcome complex payroll challenges

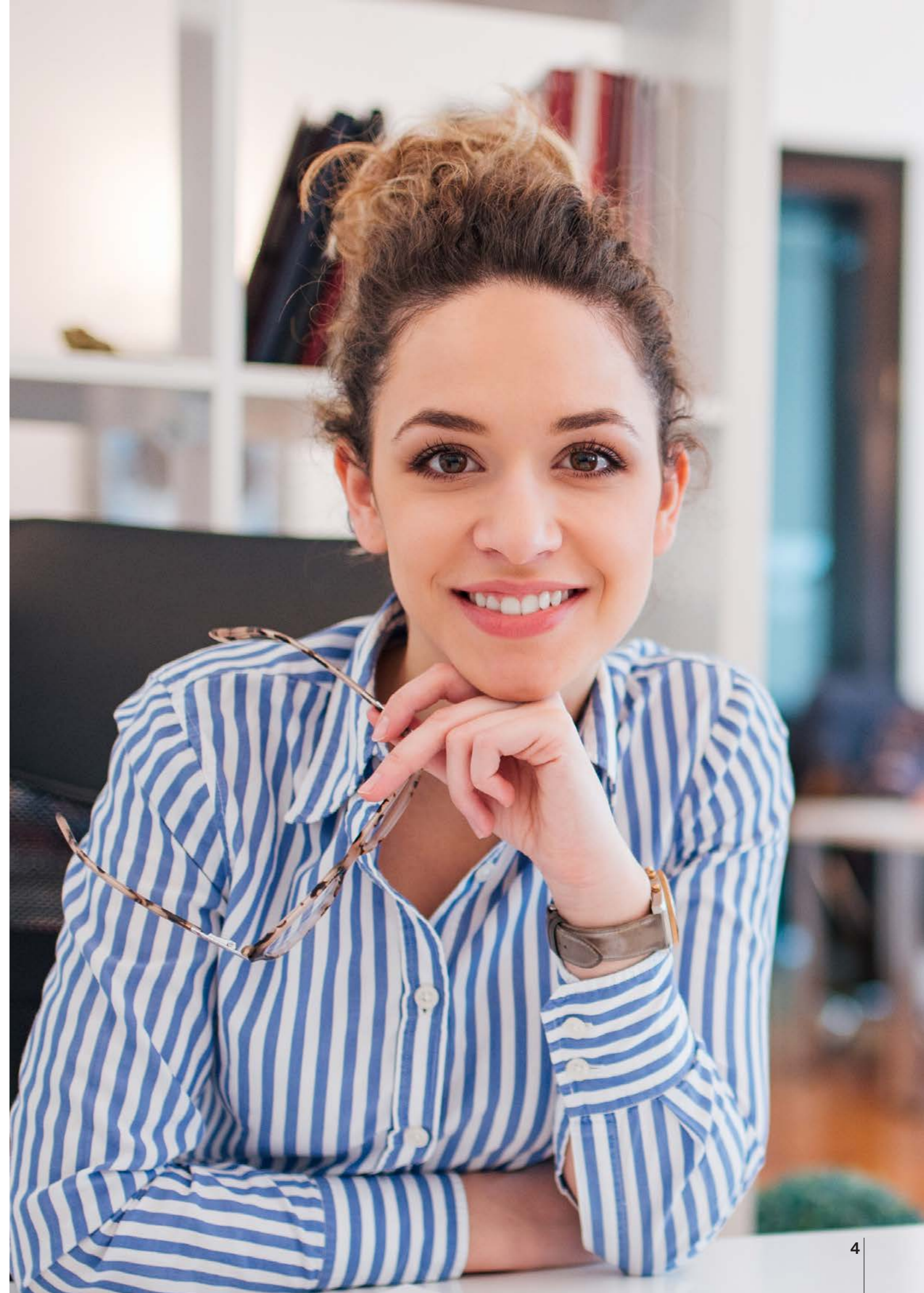


Introduction

For years, cannabis companies have worked towards the mission to improve the health, wellbeing, and happiness of people; but, unlike non-cannabis operating companies, **cannabis companies are faced with additional banking, compliance, and payroll challenges.**

Although cannabis continues to be fully legalized state-by-state, it remains federally illegal under Schedule I of the Federal Controlled Substances Act, making it difficult for cannabis companies to secure banking relationships, legally pay its people, and compete for talent.

This whitepaper will dive into **5 steps cannabis companies can take to overcome complex payroll challenges** and examine how adapting scalable, agile, technology can help mitigate compliance risk while also growing a diverse workforce.

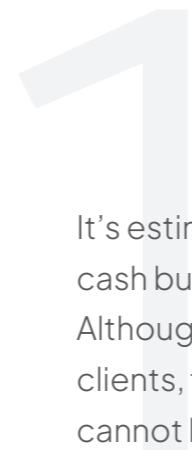


Five-step framework



Step 1: Secure a Banking Relationship

Although there is no specific law that restricts banks from taking on cannabis clients, federal law states that any money obtained from illegal transactions cannot be FDIC insured.



It's estimated that 2/3 of cannabis businesses go unbanked and operate as a cash business making them vulnerable to theft and open to compliance risk. Although there is no specific law that restricts banks from taking on cannabis clients, federal law states that any money obtained from illegal transactions cannot be FDIC insured. This makes banks wary of taking on cannabis clients, as banks are required to insure all of the depository accounts.

Furthermore, banks that follow the FinCEN guidelines are in open violation of the Bank Secrecy Act (BSA). This is why large financial institutions like Bank of America, and Wells Fargo will not knowingly take on cannabis clients.

While there are banks and credit unions out there that will take on cannabis clients, expect additional steps and fees. Your bank or credit union will need to establish comprehensive marijuana banking policies and procedures to protect themselves against the higher risks of money laundering and criminal activity that tend to occur in a commonly cash business.

This policy might include:

- [Initial Requirements Checklist](#)
- [Due Diligence Period](#)
- [Activity Monitoring](#)
- [Physical Site Examinations](#)
- [Risk analysis](#)

You will want to make sure that you gather all of your company's information including business documentation, identification documents, tax records, along with a list of vendors and suppliers so that a bank or credit union can monitor income and better flag any fraudulent account activity. In addition, you will also want to understand how legacy cash, cash that was generated prior to your new established bank account, will be handled. Many banks or credit unions may not deposit funds that do not have a detailed transaction history or audit.

Step 2: Hire a Strong HR Team

For an industry that continues to fight the stigma of being an “unprofessional” business, the ability to attract and recruit a rock star team can be trying.



Legal cannabis is the greatest job creator in the U.S. right now. However, this high-growth goes untracked as the U.S. Bureau of Labor Statistics does not recognize the industry and lumps any cannabis-related job into an assortment of other categories like agriculture, manufacturing, healthcare, or retail.

It's critical for cannabis companies to build a strong foundation of individuals to create, implement, enforce processes, and align departments. Essential to this foundation is an HR department that understands the intricacies of a highly regulated industry.

Within the HR department, there will need to be a payroll guru that knows the ins and outs of payroll, including the various tax requirements and labor laws. This payroll guru may also need to be tech-savvy and have the skills to evaluate, implement, and train others on HR technology that can alleviate cumbersome administrative tasks and help to ensure compliance.

Applicant Tracking Systems (ATS) can greatly reduce the amount of time it takes to fill open positions by posting to industry specific job boards, sourcing through resumes, and keeping the communication lines open between a hiring team and a candidate.

61,700

New cannabis jobs - 2019

36%

Growth (2018-2028)

11%

Pay more than median
U.S. salary

Step 3: Understanding and Tracking 280E

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Figure 1: Example effective tax rates

	CANNABIS COMPANY	NON-CANNABIS COMPANY
GROSS REVENUE	\$1,000,000	\$1,000,000
COST OF GOODS SOLD (COGS)	\$650,000	\$650,000
GROSS INCOME	\$350,000	\$350,000
DEDUCTIBLE BUSINESS EXPENSE	\$0	\$200,000
TAXABLE INCOME	\$350,000	\$150,000
TAX (30%)	\$105,000	\$45,000
EFFECTIVE TAX RATE	70%	30%

A dispensary might split an employee’s time between grower and budtender duties. You will want to track the number of hours this employee spends executing growing related tasks (deductible) and then track the number of hours the same employee spends in the role of a budtender (non-deductible). This employee may also receive a different rate of pay for the two positions which can be tracked within a time and labor solution

Section 280E of the Internal Revenue Code forbids businesses from deducting otherwise ordinary business expenses from gross income when it involves “trafficking” Schedule I or II controlled substances. The only exception to this rule is the ability to deduct the Cost of Goods Sold (COGS).

COGS mainly refers to inventory costs like the cost of the actual product, the cost of shipping, and any directly related expense. As a result, cannabis companies are taxed at a significantly higher rate than non-cannabis companies.

Unlike other industries, cannabis operations that engage in the cultivation, sale, or processing of the cannabis plant are not able to deduct normal business expenses like:

- Employee Payroll & Benefits
- Cost of Rent and Utilities
- Marketing and Advertising Expenses
- Facility Repair and Maintenance
- Rental Fees

Time and labor software can greatly help cannabis companies maintain compliance with 280E by tracking an employee’s labor by hours worked across different departments or positions. This will create an audit trail that includes a detail of employee tasks, time allocated to specific job functions, as well as capture the physical location of where job duties are performed.

Accurately tracking, capturing, and classifying employee labor doesn’t just help to optimize labor deductions and navigate compliance challenges, but it also produces the data you need to accurately pay and reward your people for their contributions to your company.

Step 4: Invest in a Cannabis-Friendly Payroll Solution

Although there is no specific law that restricts banks from taking on cannabis clients, federal law states that any money obtained from illegal transactions cannot be FDIC insured.



Many cannabis companies have been outsourcing payroll for years by purchasing an HR and payroll technology solution or opting to partner with a Professional Employer Organization (PEO). Recently, more and more larger payroll providers like ADP, Paylocity, and Paycom, have dropped cannabis clients and given them only 30 days' notice to find a new provider due to the high risk of handling funds.

Conducting a thorough due diligence in your evaluation for a payroll solution is critical. You will want to make sure this partner is a long-term solution that understands the unique needs of the industry. You will also want to ensure that you fully understand all of your available options so that you can make an informed selection for your cannabis business. Remember that the best providers know your business and have the technology solutions and expertise to help you achieve your goals and objectives.

PEO

A PEO is a fully outsourced solution for HR, payroll, benefits, and compliance. This may sound like any other service bureau, but with a PEO, cannabis companies are entering into a co-employment model. Under this co-employment model, the PEO will now run your payroll under the PEO's tax ID numbers. Just like a traditional service bureau, you will want to validate that there is no risk of being suddenly dropped, as the Department of Labor (DOL) has guidance warnings that will directly affect the legitimacy of PEOs and cannabis operations.

Step 4: Invest in a Cannabis-Friendly Payroll Solution

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Checklist for payroll solution providers:

- ☐ Is this partner committed to the cannabis industry?
- ☐ What is the average client size?
- ☐ Is this a true single application for HR, Payroll, Time, Benefits, and Talent Management or will it require integrations?
- ☐ Does this partner own the technology or is it a licensed solution?
- ☐ Can this solution handle MSOs?
- ☐ How will time data be captured and prepared for payroll processing?
- ☐ How will this solution scale with your organization?
- ☐ Do you need to be banked?
- ☐ Is this partner in compliance with FinCEN and the SAFE Harbor Banking Act?
- ☐ What are the responsibilities for managing and filing taxes?
- ☐ What are the expectations for client support?

Human Capital Management (HCM) Software

HCM software is technology that is purchased by a company to help streamline people management processes and outsource payroll, tax, and compliance services. HCM software does not replace your HR department, but rather empowers an HR team with the tools to better attract, retain, and engage its people.

An HCM solution preferably resides on the same database providing you with a single application and one source of data truth. A comprehensive solution should include:

- A full Applicant Tracking System (ATS) with background screening services that seamlessly flows into a paperless onboarding experience so that you can quickly attract, hire, and onboard talent.
- A time and labor solution that tracks employee hours worked and duties performed.
- A powerful payroll engine with tax compliance services that ensures deduction accuracy including the information captured in benefits management.
- A support team that can help you optimize your technology investment

As we rapidly scale our workforce with the closing of the announced acquisitions throughout 2020, we needed a nimble and scalable solution that understood the nuances of our industry

- Nirup Krishnamurthy
Chief Integration and Information Officer of Schwazze

Step 5: Properly Classify Employees

Although there is no specific law that restricts banks from taking on cannabis clients, federal law states that any money obtained from illegal transactions cannot be FDIC insured.



Figure 2: Wage classification table

	EXEMPT	NON-EXEMPT
SALARY	PAID ON SALARY BASIS	RECEIVE SALARY OR HOURLY WAGES
WAGE	MAKE AT LEAST \$35,568 ANNUALLY OF	PAID AT LEAST THE FEDERAL MINIMUM WAGE \$684 PER WEEK
JOB POSITION	HAVE HIGH-LEVEL RESPONSIBILITIES THAT AFFECT THE COMPANY'S OPERATIONS	HAVE NON-MANAGERIAL POSITIONS

With mergers and acquisitions being very common in the cannabis industry, automating and providing new hires a paperless onboarding experience is another way to mitigate risk. This experience might include a consistent process for new hires to complete important tax documents and acknowledge any company policies before starting.

Scalable and reliable onboarding software that integrates or sits on the same database as your payroll solution not only eliminates duplicate data entry, but also creates checks and balances to make sure that employees are properly classified and set up to be paid appropriately.

Cannabis companies often face the challenge of misclassifying its employees as 1099 contractors, avoiding the payment of state and federal taxes from an employee paycheck. Fortunately, there is a federal loophole, known as the “safe harbor provision” which protects companies that have mistakenly, reasonably misclassified employees as independent contractors. For those companies that do not receive protection from this provision, employers are subject to up to \$1,000 in criminal penalties per misclassified employee and up to 1 year in prison.

Beyond independent contractors, it’s critical that you properly classify all employees during the onboarding phase by differentiating between exempt vs. non-exempt and salaried vs. hourly. Your team should take overtime rules into consideration when classifying employees. All of this information captured on an employee’s first day directly impacts payroll and plays a significant role in maintaining compliance with many other laws and regulations.

Conclusion:

The future where cannabis companies can operate like any other U.S. business looks promising, but until then, cannabis companies must continue to comply with the current laws.

Agile technology that scales with both your company's organic and inorganic growth, can help you conquer complex banking, compliance, and payroll challenges, and acts as a tool to grow.

You will have all the tools to succeed in digital transformation or human resources. PeopleGuru™'s experienced gurus and our proprietary framework will guide your organization toward the path to great success.

- Rich Cangemi
CEO

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