

U.S. MARIJUANA

Christian Pot Dispensary Takes on IRS

Katy Steinmetz @katysteinmetz | Feb. 19, 2014

A business touting Christ and cannabis takes a stand over dispensaries' awkward tax status

At Lanette Davies' shop in Sacramento, everyone stops what they're doing at 6 p.m. Some patrons come especially for this moment in the day, while others just happen to be there. "We have prayer every night, for our community and our patients," she says. And those patients are all taking at least one of the same prescriptions: medical marijuana. Her shop, Canna Care, is a "Christian-based dispensary," where the owners believe in both the powers of Christ and cannabis.



Nick Adams—Reuters

The not-for-profit dispensary has a rare mix of messages, but it might also be on the verge of setting a new precedent for the marijuana industry. On Feb. 24, Davies and her husband Bryan will face the Internal Revenue Service in tax court over disputes about business deductions. A ruling in their favor could help pull dispensaries like hers out of a legal limbo—in which states view them as legitimate businesses but the IRS continues to view them as aiding in drug trafficking.

Federal law defines pot as a controlled substance, and that is the law that the IRS follows, even after 20 states and Washington, D.C., have legalized medical marijuana. "The tax law is grossly unfair," says San Francisco-based tax attorney Robert Wood, who has written extensively about the issue. "Whether you think dispensaries are a good idea or not, if they're lawful businesses under state law, they should be able to deduct their business expenses like anybody else."

So far, courts have ruled that dispensaries can't do that. Businesses like Canna Care aren't eligible for what would normally be routine deductions like payroll expenses and rent, because of a section of the federal tax code known as 280E, which dates back to 1982—more than a decade before California became the first state to legalize medical marijuana in 1996. When Davies' filed her taxes in 2006, 2007 and 2008, she listed \$2.6 million in such deductions. The IRS, which has repeatedly pursued dispensaries using that section of the code, came knocking with an audit in 2011 and refused to accept those deductions, levying nearly \$875,000 in additional taxes on Canna Care.

As it has with other dispensaries, the IRS offered to settle the case for about \$100,000, Davies says, but she refused on principle. “I could have settled this and walked,” she says, “but it would have been morally and ethically wrong to do so.” Davies believes her company is being unfairly targeted while providing a valuable service for people with serious ailments, including her husband and daughter, she says. (Her husband’s chronic arthritis converted them on the subject of cannabis.)

The IRS declined to comment.

Courts have issued rulings that suggest dispensaries are eligible for some tax deductions. In 2007, a California judge [ruled](#) that if a medical marijuana dispensary also provides extensive care-giving services, the owner may treat those businesses as separate for tax purposes. In a 2012 case, another California judge [affirmed](#) that a dispensary could deduct the cost of goods sold—i.e. the cost of the marijuana. The tax code, the judge ruled, “disallows deductions only for an expense of a business,” like providing health care plans for employees or advertising or legal services, and that does not include product. In this case, the IRS allowed Canna Care to deduct the cost of its marijuana, too.

While Wood sides with the Davies’ in spirit and says “it’s an appealing argument” that dispensaries legal under state law should be taxed like any other business, he says Congress, not the courts, will likely have to make that clarification in the tax code. “What the tax court has done is make sympathetic noises but act as if their hands are tied,” he says.

Davies remains hopeful. “It’s in God’s hands now,” she says.