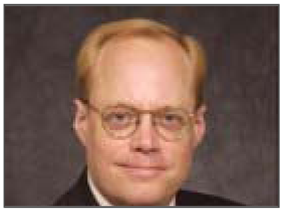

Robert W. Wood
THE TAX LAWYER

Nov. 19 2012

Is Medical Marijuana Going Corporate?

Photo credit: Wikipedia

Tax law is famously quirky, but this may take the cake. Eighteen states and the District of Columbia have legalized medical marijuana. Massachusetts was most recent. Colorado and Washington have even legalized recreational marijuana. See Colorado, Washington First States to Legalize Recreational Pot.

But even ***legal*** dispensaries are still labeled as ***drug traffickers*** under federal law. Section 280E of the tax code denies tax deductions for any business trafficking in controlled substances. The IRS says it must enforce Section 280E. Yet the U.S. Tax Court has opened the door a crack by allowing dispensaries to deduct ***other*** expenses distinct from dispensing marijuana. See *Californians Helping to Alleviate Medical Problems Inc. v. Commissioner*.

The end-run works like this. If a dispensary sells marijuana and operates the ***separate*** business of care-giving, the care-giving expenses are deductible. Some expenses might relate to both. If only 10% of the premises are used to dispense marijuana, 90% of the rent is deductible. But good record-keeping is essential. See Medical Marijuana Dispensaries Persist Despite Tax Obstacles.

But even good records won't make vaporizers or drug paraphernalia deductible. In *Olive v. Commissioner*, Martin Olive sold medical marijuana at the Vapor Room, where he used vaporizers so patients didn't have to smoke. However, with only one business, Section 280E precluded Olive's deductions.

You might assume that states legalizing medical marijuana would ensure that their state tax laws don't replicate the unfair federal tax results. Yet many states adopt the Internal Revenue Code. California's muddied tax system seems both better and worse depending on the facts.

For personal income tax, California conforms to federal Section 280E. But California's ***corporate*** tax law does ***not***. That appears to mean that a dispensary operated by a ***corporation*** in California could deduct ordinary and necessary business expenses. On the other hand, even the cost of goods sold can be disallowed in some cases. Where this result applies it seems even harsher than Section 280E. Go figure.

These are harsh and tricky tax rules impacting a business that may already be looking over its shoulder for other legal problems. The federal tax rules encourage running more than one business and allocating expenses (perhaps aggressively). Plus, tax rules in California and other states may favor corporations.

If you're in this business, take a closer look. Until the tax code is changed, taxes make for a messy and expensive situation in a business already plagued by legal and compliance issues. Further legal battles—tax and otherwise—seem inevitable.

Robert W. Wood practices law with Wood LLP, in San Francisco. The author of more than 30 books, including Taxation of Damage Awards & Settlement Payments (4th Ed. 2009 with 2012 Supplement, Tax Institute), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.