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Medical Marijuana Tax Problems?

Famously, [Al Capone](#) was finally convicted not of murder, graft or racketeering, but—tame by comparison—income tax evasion. No matter how you make your living, the tax laws apply, as Al Capone learned the hard way.

Recently, of course, U.S. taxpayers have had no end of concerns over undisclosed foreign bank accounts. See [IRS Offshore Amnesty: Second \(Last\) Chance](#) and [Tax Amnesty: IRS Voluntary Disclosure Part Deux](#). That's been a boon to the IRS and an unexpected “me too” benefit to state tax revenues. See [IRS Foreign Account Disclosure: What About The States?](#)

The IRS has benefited from some notable prosecutions that tend to have a restrictive effect on what taxpayers claim on their tax returns, especially when announced around tax time. But a smaller scale tax mess is brewing over another interaction of criminal law and taxes: medical marijuana. The IRS is pursuing the Marin Alliance for Medical Marijuana in Fairfax, California for [millions in unpaid taxes](#).

The marijuana dispensary filed returns and paid tax, but the IRS is reportedly disallowing **all** the dispensary's business expenses, no matter how ordinary and necessary they might seem. We're not talking about lavish or extravagant expenses, but the expenses every business just **assumes**—usually correctly—are proper to arrive at taxable income.

They include employee wages and benefits, rent, and well—just about everything. Why?

The IRS can't comment on an ongoing audit, but the reason is Internal Revenue Code [Section 280E](#) which precludes deductions for any business trafficking in controlled substances. California state law allows marijuana for medical use, but federal law still classifies it as a controlled substance. That's where [Section 280E](#) kicks in.

Other marijuana dispensary audits are reportedly also underway, including one of the enormous [Harborside Health Center](#) in Oakland. In these and other audits, California is truly the mother lode for the IRS. And the shovel the IRS has chosen to mine for gold is [Section 280E](#).

On the surface, the IRS seems to have an open and shut case. The language of [Section 280E](#) is clear, as is the controlled substance listing. But one U.S. Tax Court ruling says marijuana dispensaries can legally deduct expenses associated with all activities **except** dispensing marijuana. See [Californians Helping to Alleviate Medical Problems Inc. v. Commissioner](#).

This case disallowed expenses of selling marijuana, but ruled the dispensary was actually **also** engaged in the separate business of caregiving. All **those** expenses were OK. It turned out only about 10% of the premises were used to dispense marijuana, making most of the rent deductible.

If a dispensary is only selling marijuana, you might think all deductions would be verboten. But many argue that much of the work done there is counseling patients, education and advocacy. One more thing: it appears that the cost of goods sold—the inventory cost even though it is marijuana—can be claimed as a deduction.

See also:

[IRS Commissioner's letter to Congress regarding medical marijuana dispensaries business deductions](#)

[Don't Toke At Tax Time](#)

Comment: The Implications of IRC § 280E in Denying Ordinary and Necessary Business Expense Deductions to Drug Traffickers

U.S. v. Kevin Petri

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