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New DOJ Marijuana Policy Won't Fly With IRS

The feds and the marijuana industry haven't had an easy relationship. Plus, more than a few voters probably feel disenfranchised. It's been nearly a year since voters in Colorado and Washington voted to legalize marijuana. For much longer than that, we have had legalized medical marijuana. The tally is now [20 legal medical marijuana states and D.C.](#)



(Photo credit: Wikipedia)

Given the documented medical use of marijuana and state laws, you might think the feds would respect state law and states' rights. You might also assume that the sizable federal and state taxes to be collected from the industry would be a prize. Oddly enough, though, the tax law discriminates so badly against the industry that it has had to virtually go underground.

The feds' view has been that federal law controls. Medical need or not, state legality or not, marijuana is a controlled substance and illegal under federal law. Add to that the fact that many banks are reluctant to allow even legal marijuana businesses to open accounts in their institutions.

But now, one might say finally—the U.S. Department of Justice (DOJ) issued this [response](#) suggesting for the first time that it will lay off the raids and

prosecutions. But there is a big condition. The feds will lay off only if the states create “a tightly regulated market” with rules that address federal “enforcement priorities” such as preventing interstate smuggling, diversion to minors, and “adverse public health consequences.”

Those may be key phrases, but they seem imbued with considerable discretion. This [memo](#) to U.S. attorneys makes that point clear. In it, Deputy Attorney General James Cole says that the DOJ can still prosecute growers and sellers if Colorado and Washington fail to adequately address federal concerns.

As nice as it is to see some movement in the right direction, this new era is unlikely to make growers and sellers (in any state) entirely comfortable. After all, it appears to allow the DOJ wide discretion what to do. Plus, it can presumably be changed at any time.

On top of this, it is worth asking how the IRS will react to this. The tax problems of the industry are notorious and one of the major impediments facing the industry. Unfortunately, there has been no IRS announcement on the heels of the DOJ and we should not expect much. The IRS is unlikely to lay off the tax attack it has mounted against marijuana income.

The reason is that even legal dispensaries are drug traffickers to the feds. See [Voters Say Yes To Marijuana, IRS Says No](#). And the main culprit is Congress, not the IRS. [Section 280E](#) of the tax code denies even legal dispensaries tax deductions. In the past the IRS has said it has no choice but to enforce the tax code passed by Congress.

“The federal tax situation is the biggest threat to businesses and could push the entire industry underground,” the [leading trade publication for the marijuana industry reported](#). One answer has been for dispensaries to deduct expenses from *other* businesses distinct from dispensing marijuana. If a dispensary sells marijuana and is in the *separate* business of care-giving, the care-giving expenses are deductible. If only 10% of the premises are used to dispense marijuana, most of the rent is deductible.

Of course, good record-keeping is essential. See [Medical Marijuana Dispensaries Persist Despite Tax Obstacles](#). And even if one is aggressive in allocating expenses between business, there is only so far one can go. Another idea is that marijuana sellers might operate as nonprofit social welfare organizations. See [Growing the Business: How Legal Marijuana Sellers Can Beat a Draconian Tax](#). That way [Section 280E](#) shouldn't apply.

The industry needs to operate more like other businesses. See [Medical Marijuana Goes Even More Corporate](#). Sometimes such matters involve structural questions. See [C or S Corporation Choice is Critical for Small Business](#). To avoid trouble with the IRS, some claim that dispensaries should be organized as cooperatives or collectives. A cooperative is owned and governed by its members. A collective is much less structured.

The tax issues here are clearly no joke. Consider that [Harvard Law School offers 'tax planning for marijuana dealers'](#). Perhaps this fact suggests that the industry has really arrived. In other respects, though, including tax, banking and credit card processing for patients, the industry is still barely off the ground. And that is doubly disturbing, since the tax law seems an entirely inappropriate way to hinder (if not outright doom) these businesses.

Congressmen Jared Polis (D-CO) and Earl Blumenauer (D-OR) introduced the [Marijuana Tax Equity Act](#) to end the federal prohibition on marijuana and allow it to be taxed. This legislation would remove marijuana from the Controlled Substances Act. That way growers, sellers and users would not need to fear violating federal law. In addition, the bill would impose an excise tax on cannabis sales and an annual occupational tax on workers in the [growing field of legal marijuana](#).

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