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Taxes Are Killing Medical Marijuana Like Roundup

A total of [17 states and the District of Columbia](#) have legalized medical marijuana. But can dispensaries operate like other businesses? Often they can't. One reason is taxes.

We all know that businesses deduct business expenses. That's why they pay tax on their **net** income, not their **gross**. Business expenses are almost as American as apple pie, but in an almost un-American sounding rule, dispensaries can't. Why?

[Section 280E](#) of the tax code denies deductions for any business trafficking in controlled substances.

This black letter rule was meant to stop drug dealers claiming tax deductions but hits medical marijuana too. Sure, state law may **allow** medical marijuana, but federal law **still** classifies it as a controlled substance. Dispensaries are impacted, including California's massive [Harborside Health Center](#).

The IRS and Tax Court must abide by [Section 280E](#) of the tax code. However, the U.S. Tax Court has allowed dispensaries to deduct **other** expenses distinct from dispensing marijuana. See [Californians Helping](#)



(Image credit: AFP/Getty Images via @daylife)

[*to Alleviate Medical Problems Inc. v. Commissioner*](#). If a dispensary sells marijuana and also engages in the **separate** business of care-giving, the caregiving expenses are deductible.

If only 10% of the premises is used to dispense marijuana, most of the rent is deductible. Still, good record-keeping is essential. See [Medical Marijuana Dispensaries Persist Despite Tax Obstacles](#). That was one of the issues facing Martin Olive.

He set out to sell legal medical marijuana, calling his business [Vapor Room](#). Vaporizers are expensive equipment that extract marijuana's principal active component so users can inhale the vapor rather than smoke. The IRS audited Mr. Olive and presented a big bill.

Mr. Olive went to Tax Court, but it agreed with the IRS. Olive under-reported his gross receipts and, with only one business, [Section 280E](#) precluded his deductions. He owed back taxes and penalties. See [Olive v. Commissioner](#). The only good news was that the court permitted him to deduct his cost of goods sold—the marijuana he bought and resold.

The court didn't believe Mr. Olive, calling his testimony rehearsed, insincere and unreliable, and noting:

“We also do not rely on the uncorroborated testimony of petitioner's other witnesses, three of whom are (or were) patrons of the Vapor Room and all of whom are closely and inextricably connected with the medical marijuana industry and with a desired furtherance of that movement.”

More legal battles—tax and otherwise—seem certain.

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