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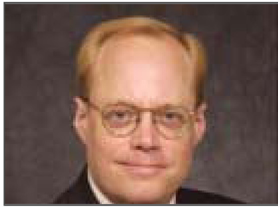

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THE TAX LAWYER

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Voters Say Yes To Marijuana, IRS Says No

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A total of 18 states and the District of Columbia have legalized medical marijuana. Massachusetts just came on line after the November 6, 2012 vote. Colorado and Washington just went further to legalize recreational use too. See Colorado, Washington First States to Legalize Recreational Pot.

But can a ***legal*** dispensary operate like a "legitimate" business? Amazingly, they can't and are still labeled as drug traffickers. Massachusetts eliminated state criminal and civil penalties for the medical use of marijuana by patients with cancer, glaucoma, HIV-positive status or AIDS, hepatitis C, Crohn's disease, Parkinson's disease, ALS, or multiple sclerosis. See Medical marijuana law passes in Massachusetts.

But no matter how "legal" the states make it the IRS is federal and that means trouble. American businesses pay tax on their ***net*** not their ***gross*** income and business expenses are as American as apple pie. But Section 280E of the tax code denies deductions for any business ***trafficking*** in controlled substances. This black letter rule to stop drug dealer tax deductions ***also*** covers medical marijuana since federal law ***still*** classifies it as a controlled substance.

Every dispensary is impacted including California's massive Harborside Health Center. Understandably, the IRS says it must abide by and enforce Section 280E. Yet the U.S. Tax Court has opened the door a crack, 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 engages in the ***separate*** business of caregiving, the caregiving expenses are deductible. If only 10% of the premises are used to dispense marijuana, most of the rent is deductible. But good record-keeping is essential. See Medical Marijuana Dispensaries Persist Despite Tax Obstacles.

But good records won't make expensive vaporizers or other drug "paraphernalia" deductible. In *Olive v. Commissioner*, Martin Olive sold medical marijuana at the Vapor Room. Vaporizers extract marijuana's principal active component, allowing patients to inhale vapor rather than smoke. The IRS presented a big bill which the Tax Court upheld. With only one business, Section 280E precluded Olive's deductions.

Mr. Olive may have had other problems—the IRS said he under-reported gross receipts. But the need for the two business allocation dance is unfortunate. If a dispensary ***only*** sells marijuana, all deductions are verboten. At least inventory costs—buying product for resale—appear to be treated as cost of goods sold and can be claimed as an offset to income.

Here again, though, good records are key. In any event, further legal battles—tax and otherwise—seem inevitable. Until the tax code is changed, taxes make for a messy and expensive situation.

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