

Cannabis Business Blog

## **A Brick Wall for the Marijuana Industry...Or the Key to The Secret Garden?**

on 8.17.15 | Posted in Federal Law, Marijuana business owners, Marijuana-related Business, Medical Marijuana Dispensary, U.S. Tax Court

In the July 9, 2015 *Olive*<sup>1</sup> decision, the Federal 9<sup>th</sup> Circuit Court of Appeals upheld a Tax Court decision that a medical marijuana dispensary was precluded from deducting any amount of ordinary and necessary business expenses associated with the operation of the business because the Vapor Room (the “business”) is a “trade or business...consist[ing] of trafficking in controlled substances...prohibited by Federal law.” I.R.C. § 280E. Deductions were limited to the “costs of goods sold.”

The Vapor Room sold only medical marijuana. It provided many other services but didn’t charge for them. The appellate court distinguished *Olive*<sup>1</sup> from the 2007 *CHAMP*<sup>2</sup> decision where the Tax Court determined that the taxpayer was engaged in two income generating businesses including the sale of medical marijuana and extensive counseling and caregiving services. In *CHAMP*<sup>2</sup>, the ordinary and necessary business expenses related to the counseling and caregiving services were deductible. See I.R.C. § 162(a).

Participants in the marijuana industry should review the facts of the *Olive*<sup>1</sup> and *CHAMP*<sup>2</sup> decisions carefully, and consult with their tax attorneys and accountants on the most tax efficient way to structure their marijuana businesses.

If the marijuana business owner also obtains revenue from the sale of non-marijuana goods and services then the ordinary and necessary business expenses related to the non-marijuana activity should be deductible.

Finally, on Aug. 10, 2015, the U.S. Tax Court published the *Beck*<sup>3</sup> decision which, in line with the *Olive*<sup>1</sup> decision, held that a marijuana business that only sold marijuana products, could not deduct any of the ordinary and necessary business expenses related to the marijuana business. Deductions were limited to “cost of goods sold” I.R.C. § 280E. The *Beck*<sup>3</sup> decision discussed the *CHAMP*<sup>2</sup> decision and upheld its holding that a business may have two or more businesses and that the ordinary and necessary business expenses relating to the non-marijuana businesses were deductible.

<sup>1</sup> Martin Olive v. C.I.R. 139 T.C. 19

<sup>2</sup> Californians Helping to Alleviate Medical Problems, Inc. – CIR (CHAMP), 128 T.C. 173 (2007)

<sup>3</sup> Beck-v-C.I.R., T.C. Memo 2015-149 (08/10/2015)

**Warning Regarding Federal Law:** The possession, distribution, and manufacturing of marijuana is illegal under federal law, regardless of state law which may, in some jurisdictions, decriminalize such activity under certain circumstances. Penalties for violating federal drug laws are very serious. For example, a conviction on a charge of conspiracy to sell drugs carries a mandatory minimum prison term of five years for a first offense and, depending on the quantity of marijuana involved, the fine for such a conviction could be as high as \$10 million. In addition, the federal government may seize, and seek the civil forfeiture of, the real or personal property used to facilitate the sale of marijuana as well as the money or other proceeds from the sale. Although the U.S. Department of Justice (DOJ) recently rescinded its guidance regarding prioritization of criminal prosecutions of individuals and entities operating in compliance with effective state regulatory systems, DOJ left in place long standing guidance to federal prosecutors regarding how to exercise this discretion. Individuals and companies are cautioned to consult with experienced attorneys regarding their exposure to potential criminal prosecution before establishing business operations in reliance upon the passage of state laws which may decriminalize such activity. Federal authority to prosecute violations of federal law as crimes or through seizures and forfeiture actions is not diminished by state law. Indeed, due to the federal government's jurisdiction over interstate commerce, when businesses provide services to marijuana producers, processors or distributors located in multiple states, they potentially face a higher level of scrutiny from federal authorities than do their customers with local operations.

**Tags:** Business Expenses, Federal Law, Marijuana business, Marijuana Business Owners, marijuana products, marijuana-related business, Medical Marijuana Dispensary, U.S. Tax Court