From the desk of
Peter S. Muffoletto, C.P.A.

Medical Marijuana Business Organized as S Corporation Loses Deduction for Shareholder's Wages

In the ongoing War of Drugs which is in part being waged in the tax courts a recent case has held against an S corporation that grows and sells medical marijuana.

The U.S. Tax Court determined that an S corporation could not deduct the wages it paid to the company's owners.

A business may deduct from its gross income all the ordinary and necessary expenses paid or incurred during the tax year in carrying on the trade or business. (Code Sec. 162(a))

However under Code Sec. 280E a taxpayer may not deduct any amount for a trade or business where the trade or business (or the activities which comprise the trade or business) consists of trafficking in controlled substances (e.g., controlled substances within the meaning of schedule I such as marijuana and II of the Controlled Substances Act) which is prohibited by Federal law.

While several states have passed laws legalizing the cultivation and sale of marijuana, this continues to be illegal at the federal level.

The S corporation in this matter, Palisades, also known as Colorado Alternative Health Care LTD is an S corporation organized under the laws of Colorado.

The owners are the sole shareholders of Palisades and also served as its officers during the years at issue (2010 through 2012).

The State of Colorado licensed Palisades to grow and sell medical marijuana.

Palisades claimed deductions from total income for ordinary and necessary business expenses (below-the-line deductions for items such as compensation of officers, wages, repairs and maintenance, rents, taxes and licenses, interest, depreciation, advertising, employee benefit programs, and other deductions).

The shareholders included on their personal income tax returns wages they received from Palisades.

For 2010 through 2012 the IRS disallowed the deductions for wages reported on the corporate tax return.

The taxpayers contested the findings of the IRS through by filing with the U.S. Tax Court.

The central issue the Tax Court considered was whether Palisades could deduct a portion of the wages it paid to the shareholders that IRS disallowed to the extent those wages were part of Cost of Goods Sold. The issue being that there is a nuance in the tax code that states that Cost of Goods Sold is not a deduction, but a reduction of gross earnings, therefore under the IRS Tax Code, allowable as a reduction of taxable income.

The Court found in favor of the IRS and that the wages were attributable to ordinary deductions and could not be characterized as COGS, and therefore were not deductible, and thereby increasing the shareholders personal income tax liabilities.

While the War on Drugs on the streets of America has been a miserable disaster, it appears that the battles in Tax Court are being won by the government.

We here at Muffoletto & Company believe that the more informed you are in regards to the rules and regulations that affect you the more we can be of service.
Should you have questions relating to any tax or financial matters call at
(818) 346-2160,
or you can visit us on the web at
www.petemcpa.com!

Providing individuals, small businesses, corporations, partnerships, professionals, and other business entities with the necessary guidance and answers for a complex world.

IMPORTANT NOTICE

The contents of this email and any attachments to it may contain privileged and confidential information from Muffoletto & Company.

This information is only for the viewing or use of the intended recipient. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution or use of, or the taking of any action in reliance upon, the information contained in this e-mail, or any of the attachments to this e-mail, is strictly prohibited and that this e-mail and all of the attachments to this e-mail, if any, must be immediately returned to Muffoletto & Company or destroyed and, in either case, this e-mail and all attachments to this e-mail must be immediately deleted from your computer without making any copies hereof.

If you have received this e-mail in error, please notify Muffoletto & Company by e-mail immediately.

To ensure compliance with Treasury Department regulations, we wish to inform you that, unless expressly stated otherwise in this communication (including any attachments) any tax advice that may be contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

If you prefer not to remain on our email lists, please let us know.We will remove you as soon as you notify us.

You may do so by emailing us at

pete@petemcpa.com