From the desk of
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Tax Court denies Business Expenses of State-legal Marijuana Dispensary

The Federal Government continues to classify marijuana as a controlled substance, and has been countering the movement by many states to legitimize marijuana usage but auditing businesses involved in what is considered drug trafficking.

Under direction of the U.S. Department of Justice the Internal Revenue Service has formed under the prior administration task forces throughout the U.S. to audit any and all businesses that are involved in the marijuana trade.

In a recent U.S. Tax Court case in Colorado the IRS held that taxpayers were precluded from deducting any business expenses related to their legal medical marijuana dispensary business.

A taxpayer may generally deduct ordinary and necessary business expenses, an exception under Code Sec. 280E prevents taxpayers from deducting any amount 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 being legal at the state level such activities continue to be illegal under federal law which classifies marijuana as a Schedule I controlled substance under the Controlled Substances Act.

In the matter of Altermeds, LLC which owned and operated a retail store, the IRS task force audited the entity and disallowed all of their business deductions.

The entity sold smokable marijuana, either as prerolled marijuana cigarettes (i.e., joints) or as dried marijuana buds, as well as marijuana in edible form, such as brownies and cakes, and orally-consumed tinctures (collectively, marijuana merchandise). In addition, the dispensary sold products that contained no marijuana, such as pipes, papers, and other items used to consume marijuana (collectively, non-marijuana merchandise).

The IRS task force examined Alterman's 2010 and 2011 tax returns.

The IRS disallowed all of Altermeds business expense deductions for the tax years of 2010 and 2011under Code Sec. 280E except for depreciation and Code Sec. 179 expensing.

The IRS issued a notice of deficiency of $452,292 for 2010, and $232,772 for 2011.

The IRS also issued accuracy-related penalties under Code Sec. 6662(a).

The court found in favor of the IRS under federal law.

Bottom line, it continues to be a highly risky business to enter into despite what any state might otherwise allow as being legal.

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