CLIENT ALERT

CANNABIS/TAX

TAX COURT RULES AGAINST CANNABIS DISPENSARY

In Patients Mutual Assistance Collective Corporation (dba Harborside Health Center) v. Comm'r, 151 T.C. No. 11, the Tax Court held, among other things, that a California medical-marijuana dispensary that was also involved in (i) the sale of non-marijuana products such as clothing, hemp bags, and books, (ii) the provision of free therapeutic services, and (iii) certain "branding" activities, was prevented by Code Section 280E from deducting any of its ordinary and necessary business expenses.

Code Section 280E provides, "No deduction or credit shall be allowed for any amount paid or incurred during the tax year carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances." [emphasis added]. Marijuana is a controlled substance under federal law (Schedule I of the Controlled Substances Act).

In Patients Mutual Assistance, the taxpayer argued that the words "consists of " in Code Section 280E were such that the Code Section 280E prohibition only applied to a trade or business that was engaged exclusively or solely in trafficking controlled substances. The taxpayer took the position that since it was engaged in other activities (sale of non-marijuana products, therapeutic services and branding), it should be able to deduct expenses related to those other activities. The Tax Court rejected the taxpayer's arguments and concluded that Code Section 280E denies any deduction for business expenses of a trade or business involving trafficking in controlled substances, regardless of whether the trade or business also undertakes other activities. The Tax Court also concluded that the taxpayer was engaged in a single trade or business (i.e., sale of marijuana which constituted trafficking in controlled substances) as its other activities had a "close and inseparable organizational and economic relationship" with the primary business of selling marijuana and/or were incidental to it.

In addition, the Tax Court held that the provisions of Code Section 263A, related to "cost of goods sold" adjustments for certain inventory costs (direct and indirect), do not apply to a trade or business subject to Code Section 280E. Rather, such a trade or business must make COGS adjustments under Code Section 471. This treatment generally prevents a "reseller" (e.g., a dispensary) from including indirect expenses (which the reseller was prohibited from deducting due to the application of Code Section 280E) in COGS. Note, under Code Section 471, a "producer" (e.g., a cultivator) must include in COGS both the direct and indirect costs of producing their inventory.

There is no doubt that the Tax Court's holdings in Patients Mutual Assistance are not favorable to those businesses operating in the cannabis industry. However, it does provide some much needed guidance regarding Code Section 280E (including its interaction with Code Section 263A) which will help taxpayers navigate this complex area of federal tax law.

This client alert is published by Dickinson Wright PLLC to inform our clients and friends of important developments in the field of cannabis and tax law. The content is informational only and does not constitute legal or professional advice. We encourage you to consult a Dickinson Wright attorney if you have specific questions or concerns relating to any of the topics covered here.

FOR MORE INFORMATION CONTACT A MEMBER OF THE DICKINSON WRIGHT TAX AND/OR CANNABIS GROUP:

J. Troy Terakedis (Tax), is a Member in Dickinson Wright's Columbus office. He can be reached at 614-744-2589 or tterakedis@dickinsonwright.com.

Peter J. Kulick (Tax), is a Member in Dickinson Wright's Lansing office. He can be reached at 517-487-4729 or pkulick@dickinsonwright.com.

Scot C. Crow (Cannabis), is a Member in Dickinson Wright's Columbus office. He can be reached at 614.744.2585or scrow@dickinsonwright.com.

Timothy I. McCulloch (Cannabis), is a Member in Dickinson Wright's Phoenix office. He can be reached at 602.285.5036 or tmcculloch@dickinsonwright.com.