TAX/CANNABIS

No Penalties in Harborside Case
by Julie Rhoades

Last week, a tax court decided that California cannabis company Harborside Inc. owes approximately $11 million in income tax payments after a ruling last year that Code Section 280E (which disallows deductions for businesses trafficking in cannabis, among other controlled substances) barred the company from deducting its ordinary and necessary business expenses for tax years 2007 through 2012.

But it could have been worse for Harborside. The tax bill did not include any penalties under Code Section 6662. Although the court held in a separate decision that Section 280E applied to the company, it also ruled late last year in T.C. Memo 2018-208 that Harborside's return positions were reasonable and taken in good faith, so penalties under Section 6662 were not warranted. At the time the final tax year in question (2012) came to a close, there was little authority regarding the application of Section 280E to cannabis businesses. And, Harborside's cofounder credibly testified that he had actively sought to comply with California law and other relevant authority then available.

Now, however, it may not be as easy for taxpayers filing returns to avoid penalties on the same basis. Since 2012, a number of additional cases have examined the applicability of Section 280E, and in 2015 the IRS issued guidance on capitalization of inventory costs for cannabis businesses. Given this additional authority, cannabis companies taking aggressive positions with respect to Section 280E may have a more difficult time establishing good faith as a defense to penalties should the IRS challenge these positions.

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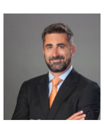

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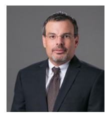

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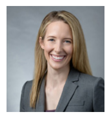

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