

Insights

Tax Court Decision Another Blow to Medical Marijuana Industry

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The recent Tax Court decision, *Alterman v. Commissioner*, struck yet another tax blow against the growing medical marijuana industry.

Though variations of medical and recreational marijuana programs have been legalized in a majority of the states, marijuana still remains classified as a Schedule I controlled substance under federal law. Section 280E of the tax code denies deductions for expenses paid or incurred in the carrying on of any trade or business involving a federal controlled substance. As a result, the Internal Revenue Service's position is that any business that deals with marijuana cannot deduct their operating expenses (including employee salaries). Thus, even if a business is operating in full compliance with applicable state regulations on marijuana, the Internal Revenue Service can still deny deductions for typical business expenses like rent, utilities, and employee wages. The result is that medical marijuana businesses have taxable income far in excess of their actual profits, which can drastically impact the viability of this industry. Because of this impact, several taxpayers in the medical marijuana industry have attempted to ignore or challenge the interpretation of the Section 280E prohibition, so far unsuccessfully.

The Internal Revenue Service's application of Section 280E has been upheld by the Tax Court previously in *Canna Care Inc. v. Commissioner*, T.C. Memo. 2015-206, and yet again two days ago in *Alterman v. Commissioner*, T.C. Memo 2018-83. Furthermore, the Tax Court in *Alterman* upheld the imposition of a 20% tax penalty on the taxpayer for the underpayment of the tax liability resulting from the deductions taken despite the Section 280E prohibition. As a result, the taxpayer not only had to pay taxes on taxable income in excess of actual profits, the taxpayer also had to pay an additional 20% as a penalty for their initial failure to follow 280E. Any businesses dealing with medical or recreational marijuana should consider carefully the impact of Section 280E, ignoring it will certainly be at their peril.

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