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Craig Smalley • Mar. 08, 2018



There was an interesting appeals case, that turned into a Writ of Certiorari^[1]. Green Solutions Retail, Inc. v. United States, started in US Tax Court. Green Solutions is a Colorado cannabis dispensary, that had its 2013, and 2014 tax returns audited by the IRS. Apparently, the dispensary ignored IRC §280E, which states:

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in 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 (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

The history of Section 280E is that it was a Congressional reaction to the landmark

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This practice by the IRS brought us *Edmundson v. Commissioner*. Jeffery Edmundson served a prison sentence for dealing drugs. When he left prison the IRS reconstructed his income from drug dealing and sent him a NOD. Edmundson petitioned the Tax Court. Under the Cohen Rule^[2], Edmundson stated that he bought the drugs on consignment, he had some travel expenses, telephone, and other expenses, that the Tax Court gave him credit for. In the 80's the United States Government was fighting the War on Drugs, and Section 280E was a direct reaction, by Congress to Tax Court's ruling. In the appeals case for Green Solutions, and also in the Writ of Certiorari, the dispensary raises many objections to 280E, however I think the reason the Court might hear this case is the fact that they raise the objection to the Code Section, stating that 280E is a penalty and not a tax.

The penalty and not a tax argument, we should all remember from the Supreme Court Case, *National Federation of Independent Business v. Sebelius*. The case challenged the Constitutionality of the Affordable Care Act (ACA). The particular issue was that they government couldn't force a person to purchase health insurance. The "penalty" the US Government was to charge for not having health insurance was Unconstitutional. SCOTUS, in its ruling, stated that the penalty was Constitutional because it was actually a tax.

When we look at IRC §280E, we notice that the law only affects the drug trade. Here is what is interesting, if you think of the most heinous of monetary crimes, we can look at something like human trafficking. When a human trafficking ring is broken up, and the people are arrested, typically the head of the ring will find themselves in the cross hairs of the IRS. These ring leaders, profited financially, from kidnapping, sale, prostitution, of mostly women and children. If their income is reconstructed by the IRS, these people can deduct ALL of their expenses.

In 1982 when 280E is enacted, Congress never had a clue that in 2018 there would be

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Section 280E affects a cannabis company that is legal under state law, however it also affects cocaine, heroin, and methamphetamine dealers. SCOTUS, if they side with the dispensary, would be overturning this law for the black market^[5], as well as these cannabis companies. Of course, Congress would either be left to fix 280E, or not do anything at all. There are legal ways around 280E, however they are expensive for the cannabis owner to pay someone like me to construct, and watch the various companies the owner must have to avoid this tax.

White collar businesspeople make the mistake thinking that cannabis is a white collar business. If you ever talk to most owners in the cannabis industry, and work with them at the level that I do, you realize very quickly that 98% of those in the industry came from the black market. They are innately businesspeople. Each knows their numbers, has connections for their supplies, and when they know what a business plan and executive summary are, they realize they have been doing those in the black market.

I spend a lot of time with these owners, because most white collar businesspeople want to try to take advantage of the people coming out of the black market, and into the grey market as I like to call it. The really sad thing, is I got into cannabis, because I have always been a small business owner, and to think that I couldn't deduct my expenses, didn't set well with me. However, I spend a lot of my time forging connections, and protecting these owners from what I call the "cannabis price." The cannabis price is when an ignorant white collar person thinks that these companies are rolling in money, and grossly overcharge for their services. In fact, about 97% of the companies that have given us the case law on 280E are out of business, because their legal fees and accounting fees were too high. Not to mention, that most companies pay 70% in federal taxes.

Is 280E a penalty? If we look at the law, realizing that it only affects the sale of drugs,

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the presidential administration hasn't come out and given their official opinion of state legal cannabis. Jeff Sessions the Secretary of State, has stated that he will enlist the Drug Enforcement Administration (DEA) to enforce the federal cannabis laws on the legal cannabis industry. He even tried to rescind the Cole Memo^[10]. This really made me laugh. There are about 6-8 million businesses in the cannabis space, and according to Sessions we are going back to DEA raids? We can't even fund the IRS, much less the DEA.

This would be the right place to mention that Congress, albeit a very slow and painful process to watch, has several bills that are in the sponsoring and co-sponsoring stage that would take care of various issues the cannabis industry faces. One of them being Section 280E. However, these companies are going out of business all of the time. I've had cannabis clients for almost seven years now, and very few accountants work with these clients like we do. There are tons of cannabis companies that have never heard of 280E, or their accountants don't specialize in 280E, and the next thing you know they get a lesson really quickly that their companies are set up wrong, and there have been no measures made to alleviate Section 280E. The taxes on these companies can be, effectively, away high as 70%. This high tax puts a lot of first year cannabis companies out of business.

Something has to be done about 280E. I know that I have devised all sorts of tax plans that avoid the tax, however these plans cost less than the tax these companies would pay without the plan, but are more expensive for the business owner to implement than most other companies.

^[1] A petition to the United States Supreme Court (SCOTUS) to hear a case

[2] Cohen v. Commissioner stated that a taxpayer without records could introduce

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throughout the United States. Some excise taxes are collected from the producer or retailer and not paid directly by the consumer, and as such often remain “hidden” in the price of a product or service, rather than being listed separately.

[7] A special retirement plan that allows for a business owner to potentially make tax-deductible contributions in excess of the floor of \$54,000 in 2018

[8] Latin for “on the face of”

[9] Slang for Writ of Certiorari

[10] The memo issued by James Cole in 2013, that allowed for cannabis companies to open a bank account

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