

2019 Medical Marijuana Symposium

Tax Law Update &
Business Impact
on the
Cannabis Industry

James D. Thorburn, Esq.
Thorburn Walker, LLC

March 22, 2019

Change makers in Cannabis Tax Law™

Copyright 2019 Thorburn Walker, LLC

JUSTICE GORSUCH ON STATE- LEGAL MARIJUANA



"This case owes its genesis to the mixed messages the federal government is sending these days about the distribution of marijuana."

Feinberg v. C.I.R., 808 F.3d 813 (10th Cir. 2015).

"So it is the government simultaneously urged the court to take seriously its claim that the petitioners are violating federal criminal law and to discount the possibility that it would enforce federal criminal law."

Feinberg, 808 F.3d at 815.

"In light of questions and possibilities like these, you might be forgiven for wondering whether, memos or no memos, any admission by the petitioners about their involvement in the marijuana trade still involves an "authentic danger of self-incrimination."

Feinberg, at 816.

Copyright 2018 Thorburn Walker, LLC

GENERAL BACKGROUND

Three Years Later:

“[T]he Department of Justice has specifically rescinded its former policy of non-prosecution for marijuana dispensaries complying with state law, evidencing governmental intent to enforce this law.”

Alpenglow Botanicals, Ltd. Liab. Co. v. United States, 894 F.3d 1187, 1206 (10th Cir. 2018)

“A HUGE FEDERALISM DISPUTE”

Statement by Judge Carlos F. Lucero, 10th Circuit Court of Appeals, January 22, 2019
Feinberg v. Commissioner, 18-9005, oral argument beginning at 13:30.

Judge Lucero:

“Ms. Ugolini (Francesca Ugolini, Assistant Chief Counsel, Department of Justice), these cases are frustrating, because under the Constitution, under the Tenth Amendment, of course the powers of the federal government are limited to the powers granted under the Constitution, and the States reserve certain powers. What we have here, basically, is a huge federalism dispute.

“Colorado says it is legal to grow and sell marijuana. The federal government says marijuana is a controlled substance. Now your role in the tax business is not to go around prosecuting people or not prosecuting people. Your job is to raise taxes. And normally, in the ordinary course of business, you allow a business that is legal to deduct against their gross sales all expenses, either the costs of goods sold, or the costs of production, etc. So, the IRS says in this case, even though the business is legal in Colorado, because the federal government says it is not legal to sell marijuana, “traffic in marijuana”, you’re going to have to pay taxes on the whole bloody thing. No costs of goods sold. No costs of production. Colorado, up yours! We are going to ignore anything that you as a State, under the United States Constitution, have the power to do and has done. . .”

“A HUGE FEDERALISM DISPUTE”

Statement by Judge Carlos F. Lucero, 10th Circuit Court of Appeals, January 22, 2019
Feinberg v. Commissioner, 18-9005, oral argument beginning at 13:30.

Judge Lucero:

“So, it’s your interest here to raise taxes. But you’re saying is “ok we’re not only going to raise taxes, we are going to punish this business, to the point of destruction”, and you get into this huge mix of tax raising and criminal law.

“Now these taxpayers come and say, “Well, if you will kindly give us protection, we’ll give you any record you want, but we don’t want to give you records if the federal government can turn around and prosecute us”. So, as I understand it, you send auditors out, I don’t know for what purpose? What are you trying to do, prove that they are selling marijuana? They are admitting they are selling marijuana. They’re admitting they’re growing marijuana. They’re saying, “that’s all legal under the power of the State of Colorado to so declare”.

“A HUGE FEDERALISM DISPUTE”

Statement by Judge Carlos F. Lucero, 10th Circuit Court of Appeals, January 22, 2019
Feinberg v. Commissioner, 18-9005, oral argument beginning at 13:30.

“But what you are trying to do, it seems to me with all due respect, is not just raise ordinary and necessary taxes, but what you’re trying to do is take this company or any company – forget this company – just look at the entire industry, and say “we’re going to tax 100% of gross sales, no exemptions, whatsoever, for the costs of goods, or for the deductions that would ordinarily and normally granted any business that are legally operating within their state. And that seems to be more the power to destroy. “So, what I’m looking at is this, first of all, has any court declared the constitutionality of 280E in the context of whether it is constitutional to deprive the costs of goods sold or the costs of production when a taxpayer is paying their taxes purely for tax purposes. If you would address that please – the cases that have so ruled.”

CRIMINAL SUBPOENAS HAVE STARTED

Grand Jury has been empaneled

Not known yet how far reaching the Grand Jury investigation is

CONGRESS STILL TRIES TO CHANGE LAW

From *Accounting Today*, February 2019:

Senator Ron Wyden, D-Ore., and Rep. Earl Blumenauer, D-Ore., have introduced legislation to legalize cannabis and prevent legal marijuana businesses from being hit with punitive tax bills.

The Senate version of the bill, S. 420, the Marijuana Revenue and Regulation Act, aims to responsibly legalize, tax and regulate marijuana at the federal level. The legislation is part of a broader package that is being introduced in the Senate by Wyden, the ranking Democrat on the Senate Finance Committee, and in the House by Blumenauer, a senior member of the tax-writing House Ways and Means Committee.

IRS AND DOJ

- IRS claims Section 280E audits are strictly “civil” but now has full authority to investigate whether drug crimes have occurred.
- IRS generally refuses to grant use immunity to production of documents in 280E audits and government fully reserves the right to prosecute taxpayer for violations of federal criminal drug laws based upon the documents produced in the civil audit.

THE IRS 280E CRIMINAL INVESTIGATION

“The IRS made initial findings that Green Solution trafficked in a controlled substance and is criminally culpable under the CSA. The IRS then requested that Green Solution turn over documents and answer questions related to whether Green Solution is disqualified from taking credits and deductions under § 280E.”

Green Sol. Retail, Inc. v. United States, 855 F.3d 1111, 1113 (10th Cir. 2017).



THE IRS 280E CRIMINAL INVESTIGATION

“The IRS issued a *Notice of Deficiency* concluding that Alpenglow had ‘committed the crime of trafficking in a controlled substance in violation of the CSA’”.

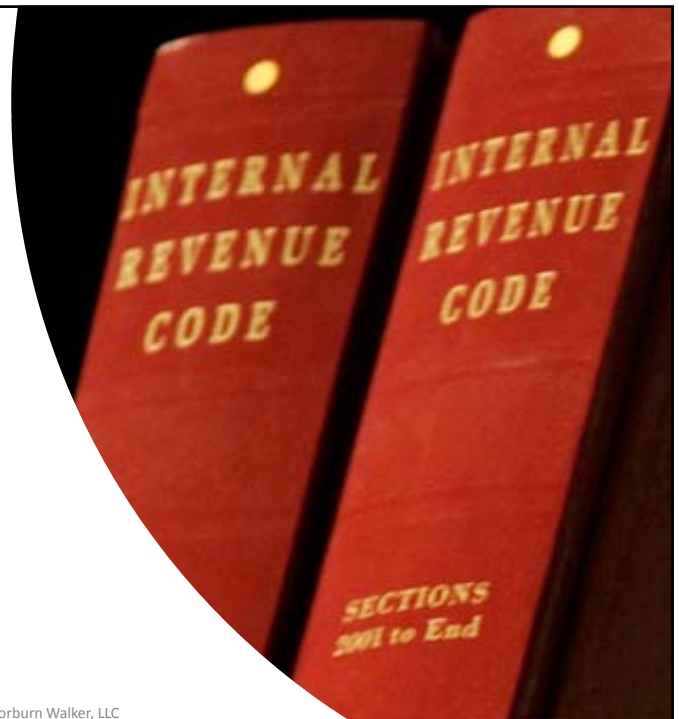
Alpenglow Botanicals, Ltd. Liab. Co. v. United States, 894 F.3d 1187, 1193 (10th Cir. 2018)



Compliance and 280E

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.

26 U.S.C. §280E



WHAT IS THE IRS/DOJ LOOKING FOR?

- IRS CLAIMS THAT IT IS LOOKING SOLELY TO DETERMINE PROPER TAX
- HOWEVER, REFUSAL TO GRANT IMMUNITY
- RESERVES ALL RIGHTS TO USE ANY AND ALL INFORMATION OBTAINED IN THE AUDIT FOR CRIMINAL DRUG LAW PROSECUTION PURPOSES



THE RESULT

- Tax May Exceed Net Income



COSTS OF GOODS SOLD A CONSTITUTIONAL RIGHT

Congress has the unquestioned constitutional and statutory authority to tax gross income. . . To ensure taxation of income rather than *sales*, the "cost of goods sold" is a mandatory exclusion from the calculation of a taxpayer's gross income.

Alpenglow Botanicals, Ltd. Liab. Co. v. United States, 894 F.3d 1187, 1199 (10th Cir. 2018)

Deductions are a matter of legislative grace, but Congress does not have legislative grace to costs of goods sold. *Id.*

"Treasury Regulations include "inventory price," "transportation or other necessary charges incurred in acquiring possession of the goods," "cost of raw materials and supplies," "direct labor" costs, and "indirect production costs" as some of the mandatory exclusions to gross income." *Id.*



COSTS OF GOODS SOLD A CONSTITUTIONAL RIGHT

"The Constitution does limit Congress to taxing only gross income, and courts have consistently held--including in cases *Harborside* cites--that gross income is gross receipts minus direct costs."

Patients Mut. Assistance Collective Corp. v. Commissioner, Nos. 29212-11, 30851-12, 14776-14, 2018 U.S. Tax Ct. LEXIS 54, at *48 (T.C. Nov. 29, 2018) (*Harborside*)

No Indirect Costs of Production Allowed under Harborside



COSTS OF GOODS SOLD A CONSTITUTIONAL RIGHT

ALPENGLOW
vs
HARBORSIDE ??



10th Circuit Appellate Cases



- *Feinberg v. Commissioner*, 18-9005 (10th Cir.) Burden of proof. Does requiring the taxpayer to prove innocence of criminal drug laws to obtain tax deductions violate the taxpayer's Fifth Amendment rights?
- *High Desert Relief v. United States*, 17-2095 (10th Cir.) – Oral Argument held March 21, 2018 – Judge Lucero Presiding Judge
 - *Whether summoning information above federal drug crimes is a proper purpose.*
- *Alpenglow Botanicals, Ltd. Liab. Co. v. United States*, 894 F.3d 1187 (10th Cir. 2018). Section 280E with respect to 16th Amendment and Eighth Amendment. Petition for Cert due February 22, 2019.

Thorburn Walker, LLC
5460 South Quebec Street, Suite 310
Greenwood Village, CO 80111
(303) 646-3482
jthorburn@thorburnwalker.com

Change makers in Cannabis Tax Law™

Thorburn Walker LLC offers over 50 years of combined legal and CPA experience and represents Colorado dispensaries in a variety of ways. They are keenly aware of the current federal and state issues affecting Colorado dispensaries and work hard to achieve successful results for their clients.

They help dispensaries navigate through these complex legal issues including tax court and IRS audits. Their services range from representation of dispensaries in IRS audits and tax court, including section 280E issues.

Thorburn Walker also provides general business representation, helping dispensaries comply with the regulations under the Colorado Medical Marijuana Code.

Q & A



Thorburn Walker, LLC
5460 South Quebec Street, Suite 310
Greenwood Village, CO 80111
(303) 646-3482
jthorburn@thorburnwalker.com

Change makers in Cannabis Tax Law™