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Ninth Circuit: Marijuana dispensary's claimed expenses properly denied

The U.S. Court of Appeals for the Ninth Circuit today, in affirming a decision of the U.S. Tax Court, held that the taxpayer—one of the largest marijuana dispensaries in the United States—was not allowed to claim deductions for expenses because of the effect of section 280E.

As the Ninth Circuit summarized:

> *… this dispute reflects the latest attempt by a medical marijuana retailer to ameliorate the significant tax consequences Congress has prescribed for businesses that Congress regards as trafficking in controlled substances. Under federal law, those prohibited substances include marijuana, even though some states have more recently legalized its sale. This disharmony between federal and state law produces the multi-million-dollar tax controversy before us. Ultimately, we hold that the taxpayer's arguments either are without merit or were not preserved for our review. We therefore affirm the Tax Court.*

The case is: *Patients Mutual Assistance Collective Corp. v. Commissioner*, No. 19-73078 (9th Cir. April 22, 2021). Read the Ninth Circuit's **decision** [PDF 188 KB]

Overview

The taxpayer—a not-for-profit corporation and medicinal cannabis collective that operates a retail cannabis dispensary under California state law—claimed "tens of millions of dollars in exclusions." The IRS disallowed nearly all of them, and then issued notices of deficiency. The Tax Court held for the Commissioner, and this appeal followed.

As the Ninth Circuit observed, most corporations can claim deductions for "ordinary and necessary expenses" that are "paid or incurred during the taxable year in carrying on any trade or business." However, deductions that are otherwise allowed are not available to taxpayers that engage in certain activities that Congress regards as unlawful, including trafficking in controlled substances like marijuana (see section 280E).

The Ninth Circuit declined to consider the taxpayer’s constitutional claim (not raised before the Tax Court) that section 280E violates the Sixteenth Amendment. The appeals court also rejected the taxpayer’s claim that some of its expenditures, even if they could not be deducted under section 280E, could be excluded from income as part of its inventory cost under general inventory tax accounting rules.

The Ninth Circuit concluded that the Tax Court did not err in finding that the taxpayer’s inventory cost is determined by Reg. section 1.471-3(b), which applies to a purchaser and reseller of the products it sells.

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