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HEADLINE: #17 2015 TNT 90-17 ABA MEETING: AGENTS WORKING WITH POT GROWERS OK WITH OPR, HAWKINS SAYS. (Section 280E -- Illegal Drug Sales) (Release Date: MAY 08, 2015) (Doc 2015-11178)

CODE: *Section 280E* -- Illegal Drug Sales

ABSTRACT: In a valedictory address May 8 before the American Bar Association Section of Taxation annual meeting in Washington, Karen L. Hawkins, outgoing director of the IRS Office of Professional Responsibility, turned to a burning question: Can marijuana retailers deduct the cost of goods sold?

SUMMARY: Published by Tax Analysts(R)

In a valedictory address May 8 before the American Bar Association Section of Taxation annual meeting in Washington, Karen L. Hawkins, outgoing director of the IRS Office of Professional Responsibility, turned to a burning question: Can marijuana retailers deduct the cost of goods sold?

The Office of Chief Counsel issued a memorandum (ILM 201504011) January 23, "Taxpayers Trafficking in a Schedule I or Schedule II Controlled Substance -- Capitalization of Inventoriable Costs," to explain the question, Hawkins noted, though she added that the issues raised in the memo are "very hard, if you're not immersed in accounting methods and inventory methodology and cost of goods sold."

"The only concern I have is, the folks that I certainly have become aware of in the marijuana growing and dispensing industry are not rocket scientists," added Hawkins, who on May 6 announced her resignation from OPR. "I'm not sure that any of them, unless they're going to pay a lot of money to hire some of the smartest accounting firms in the country to do their cost of goods sold analysis, will understand what [the chief counsel] advice is saying to them."

Hawkins said she'd been asked to make statements about OPR's perspective on the matter, especially from enrolled agent groups in Colorado and Washington state (where marijuana is legal). Tax practitioners have two concerns, she said.

"They're concerned at the front end, like the banks are being, that even taking a client who is a grower or a dispenser, is somehow a violation for them that will get them in trouble," Hawkins said. Banks are reluctant to take deposits from marijuana businesses because pot is still a Schedule 1 drug and they fear being prosecuted under federal money laundering laws. The second concern practitioners have "is more troubling for [them] and it's harder to give guidance" on, Hawkins said, namely what practitioners tell growers and dispensers what they can deduct besides cost of goods sold.

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Banks Don't Do Pot

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Former Attorney General Eric Holder tried to assuage banks' fears January 22 during an appearance at the University of Virginia, where he hinted at the forthcoming chief counsel's memorandum. But "there are a lot of banks who don't believe that informal observation to the rest of the United States Attorneys, and probably with good reason," Hawkins said, based on the actions she's seen of the U.S. attorney in California.

"I have made it very clear . . . that from the Internal Revenue Service point of view, we view these activities in the same way that we view the illegal immigration issues," Hawkins said. "The Internal Revenue Service is about getting as many people to report their income and pay the right amount of tax into the system, without worrying about what other illegal activities they may be involved with, outside of what [the IRS Criminal Investigation Division] may be concerned about for different reasons."

The simple fact that an enrolled agent takes on a client who is a marijuana grower or dispenser is not going to raise an issue with OPR, Hawkins said.

Growers Want to Pay Taxes

The second concern practitioners have "is more troubling for [them] and it's harder to give guidance" on, Hawkins said, namely what they can tell growers and dispensers is deductible besides cost of goods sold.

A 2007 Tax Court case, *Californians Helping to Alleviate Medical Problems Inc. (CHAMP) v. Commissioner of Internal Revenue*, 128 T.C. 173 (2007) (Doc 2007-11902), "is probably the roadmap, for the time being, for the right kinds of due diligence that need to be done by a return preparer who is dealing with someone in the marijuana business," Hawkins said.

CHAMP was conducting other kinds of health-oriented activities -- meditation, yoga, other educational classes -- for people who used medical marijuana for their health issues, Hawkins noted. The Tax Court allowed CHAMP to carve out those expenses and treat them as other kinds of business expenses not associated with dispensing pot, she said.

The *CHAMP* case gives the best outline, Hawkins said, "of ascertaining what are the deductions that you'd like to take, and then which ones are you actually going to be able to get on the return, and which ones are you going to have to tell the client, until the law changes, they're going to have to eat it."

Legal pot is creating a lot of headaches for the IRS, Hawkins said.

"The dispensaries and the growers want to pay their taxes," she said. "They do not want to be in trouble. They're going to make a lot of money. . . . They don't need to cheat." But without a bank to take their tax deposits, marijuana business owners are showing up at taxpayer assistance centers "with bags of cash, which is making the IRS very nervous," she said.

"My question has been, once we take that money and we take it to the bank, have we just helped them money launder?" Hawkins asked. "I think the answer is yes, but who's going to prosecute the IRS?"