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Tax Practice: IRS Guidance Coming for Practitioners Preparing Returns for Marijuana Retailers

By Casey Wooten

Tax preparers whose clients include marijuana retailers will get some guidance in early 2015 on how to perform due diligence and stay on the right side of the law, an official from the IRS Office of Professional Responsibility said.

It's important for the OPR to make a statement on ethical practices for preparers in the growing number of states where marijuana is legal, OPR Director Karen Hawkins said Nov. 19 at a public meeting of the Internal Revenue Service Advisory Council.

"I'm going to stay away from the controlled substances issue and focus on what the tax courts have said, so cost of goods sold is in play, but anything else that's in play is going to depend on whether it's part of the trade or business of cultivating or sale, or whether it's a subsidiary trade or business that just happens to have a connection," Hawkins told Bloomberg BNA.

Tax Compliance Headache.

In recent years, states such as Colorado and Washington have legalized recreational marijuana use, while California, Washington, D.C., and others have either decriminalized it or decided to allow it for medical use. Marijuana sales are still illegal under federal law, however.

Because of federal anti-money laundering rules, banks are reluctant to service marijuana retailers, who in turn must operate their businesses mostly in cash. This can create a headache from a tax compliance perspective, making it difficult for businesses to use government services such as the Electronic Federal Tax Payment System.

In July, Sen. Michael Bennet (D-Colo.) and Rep. Ed Perlmutter (D-Colo.) wrote to IRS Commissioner John Koskinen, asking him to stop the agency from penalizing marijuana businesses from paying their employees' withholding taxes in cash (135 DTR G-3, 7/15/14).

Legal Trouble.

Much like banks, practitioners are concerned that preparing returns for marijuana growers could lead to legal trouble, Janeen Ryan, a member of the advisory council, said.

“We were approached by people that are professionals and 230 legacy preparers and they said ‘we are concerned to even do their returns,’”said Ryan, who helped write the annual advisory report section on marijuana retailers.

The IRS can't change Tax Code Section 280E, which prevents deductions or credits for expenses if a business is involved in the trafficking of controlled substances; that change requires congressional action.

Until then, marijuana retailers are only able to deduct for the cost of goods sold, Ryan said.

But the agency can issue a clarification that preparers' practices won't be affected.

In their report, members of the advisory panel suggested that the IRS publish guidance clarifying that a tax professional won't be considered unethical, targeted for audit or considered in violation of Circular 230 rules solely for preparing a return for a marijuana business.

Court Action.

Hawkins said there are court cases defining what kind of deductions marijuana retailers can take that will help her shape the guidance on this issue.

She referred to a 2007 case, *Californians Helping to Alleviate Medical Problems Inc. v. Commissioner*, in which the U.S. Tax Court ruled that Section 280E didn't prevent a California organization providing medical marijuana from deducting expenses related to a separate part of the businesses (94 DTR K-1, 5/16/07).

“Within those parameters what we would essentially be saying to the preparers in those states is that you've got some hard conversations to have with your clients about what goes on to the tax return, but as long as you are adhering to what the tax law says about treatment, you're going to be within the confines of what Circular 230 expects of your due diligence,” Hawkins said.