“REVERSE AL CAPONE-ISM” AND THE TAX TREATMENT OF MARIJUANA BUSINESSES

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I. THE FEDERAL TAX LAW IS INTENTIONALLY PUNITIVE

Congress enacted IRC § 280E in 1982 because it was dissatisfied with the Tax Court’s 1981 decision in Edmondson v. Commissioner, T.C. Memo. 1981-623, 42 T.C.M. (CCH) 1533. That decision allowed tax deductions for the legal business expenses incurred by a Minneapolis drug dealer. IRC § 280E denies a deduction or credit for business expenses associated with operating a trade or business consisting of trafficking controlled substances that are listed in Schedule I or Schedule II of the Comprehensive Drug Abuse Prevention and Control Act of 1970 (“CSA”). Marijuana is listed in Schedule I of the CSA.

The Senate Committee Report accompanying the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) clearly muddled its rationale:

Reasons for Change
There is a sharply defined public policy against drug dealing to allow drug dealers the benefit of business expense deductions at the same time that the U.S. and its citizens are losing billions of dollars per year to such persons is not compelled by the fact that such deductions are allowed to other, legal, enterprises. Such deductions must be disallowed on public policy grounds.¹

Despite the syntax lapse, the Committee Report is crystal-clear on what the Senate meant when it adopted Sec. 280E:

Explanation of Provision
All deductions and credits for amounts paid or incurred in the illegal trafficking in drugs listed in the Controlled Substances Act are disallowed.²

Congress stated in 1982 that it was motivated by a strong public policy to punish drug dealers. Although there has been considerable state action liberalizing the treatment of marijuana in recent years, no evidence has been cited to indicate that there has been any change in the federal government’s policy toward drug dealers. Nor has any evidence been cited to indicate that Congress distinguishes marijuana dealers from any other type of drug dealers.³

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² Id.
³ DOJ enforcement policy distinguishes marijuana dealers who comply with state law from other drug dealers. This policy is inconsistent with applicable federal laws. See U.S. Dep’t of Justice, Office of the Deputy Attorney General, Memorandum for All United States Attorneys: Guidance.

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II. STATE LAW IS ALMOST IRRELEVANT

Regardless of how many state legislatures purport to legalize the manufacture and sale of marijuana, the business of manufacturing and selling marijuana remains illegal under federal law. And the Supremacy Clause of the U.S. Constitution requires inconsistent state laws to defer to federal law:

>This Constitution, and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding. 4

Proponents of liberalizing marijuana laws simply must acknowledge that there is no marijuana exception to § 280E, and there is no evidence that Congress wants one. Congress clearly intended to impose the financial penalty experienced by those in the marijuana businesses, i.e., that they are in effect obligated to pay federal income tax on their gross income. Section 61(a) does not differentiate between income derived from legal sources and income derived from illegal sources. 5

III. KAHN AND BROMBERG ARE ADVOCATES FOR THE COMPLETE REPEAL OF § 280E

In their 2016 Florida Tax Review article 6, Professors Kahn and Bromberg argue that § 280E should be repealed because of its flaws as a civil penalty. The principal flaw they discuss stems from their belief that “the punishment should fit the crime” and that § 280E is arbitrary because it contains no protections for the concept of “horizontal equity.” 7 They introduce this notion in prompting the current dialog, but they quickly dismiss it, stating that it is not the central focus.

I disagree, and suggest that § 280E is indeed the central focus that underlies the current marijuana dialog. I would certainly agree that the practical impact of § 280E is often disproportionate to the severity of the harm caused to third parties by the offense. But that is the yardstick used by criminal law to measure the propriety of a penalty. In the case of a civil-law penalty, including most tax penalties, it is customary for the penalty’s impact to be directly proportional to the offender’s conduct. Most importantly in this instance, it is completely within the offender’s control.

Congress is presumed to have intended to mean what it said — at least until it changes its mind. In this case, Congress clearly and explicitly used the tax law to impose an additional penalty on certain drug offenders, and has never wavered or apologized for the rough justice that ensues.

IV. HOW MARIJUANA COULD BE LEGALIZED

The Constitution contains at least two remedies for those who believe marijuana should be treated differently from other Class 1 drugs. The simplest remedy is to elect senators and representatives who are willing to enact laws that reclassify marijuana. Failing that, the Constitution permits amendments. There is precedent in the laws


4 U.S. CONST. Art. VI, Cl. 2.
7 Id. at 217.
governing the treatment of beverage alcohol – in both the adoption of Prohibition in 1919 by the Eighteenth Amendment and its repeal in 1933 through the Twenty-First Amendment.

It is true that a number of states have made marijuana legal, and our Canadian neighbors seem headed in that direction as this article is being written. However, today’s advocates of legalizing marijuana have been unable to win the only battle that really matters: a potential debate in the U.S. Congress that would result in the removal of marijuana from Schedule I of the CSA. In addition, they seem to have little or no interest in exerting the energy required to amend the Constitution.

I suggest that those advocates who want to create a “marijuana exception” within § 280E are engaging in “reverse Al Capone-ism.” In the 1930’s the FBI became frustrated with its inability to make a case against Al Capone for racketeering, bootlegging, extortion and murder. It turned instead to the income tax law to do indirectly what it was unable to do directly. The FBI put Capone away for tax evasion. So, like J. Edgar Hoover and Elliot Ness, marijuana advocates are now turning to the tax law in hopes of accomplishing indirectly what they have failed to do directly. They want to use the tax law to normalize the economics of the marijuana trade.