

# Income tax challenges for medical marijuana businesses in Oklahoma

On June 26, Oklahoma voters approved State Question 788, which legalizes the use, growth, and sale of marijuana in the state for medicinal purposes. In addition to providing rules for individual use of medical marijuana, the approval of SQ 788 also created a number of opportunities for new related businesses, such as retailers or dispensaries, commercial growers and processors. However, although licensed medical marijuana businesses are now legal under Oklahoma state law, [conflicting federal law](#) creates a number of challenges for business owners, particularly with respect to federal income tax law.



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Generally, the Internal Revenue Code allows a taxpayer to take a deduction for all “ordinary and necessary” business expenses paid or incurred during the taxable year. Congress has created an exception to this rule in certain instances, however. One such exception is Internal Revenue Code Section 280E, which prohibits a taxpayer engaged in the business of “trafficking in controlled substances” from taking a deduction for ordinary business expenses. For purposes of this provision, a controlled substance is any Schedule I or Schedule II drug under the federal Controlled Substances Act, which includes marijuana. Although taxpayers have argued that Code Section 280E should not apply to businesses operating legally under state law, courts have repeatedly rejected this argument, concluding that any business buying or selling marijuana regularly is subject to the restrictions of Code Section 280E until Congress chooses to amend the Internal Revenue Code.

Although Code Section 280E’s bar on deductions represents a significant obstacle for medical marijuana business owners, several exceptions help reduce the burden on these taxpayers. For example, although a medical marijuana business cannot deduct expenses in the same way as other taxpayers, it is entitled to offset its gross receipts with its cost of goods sold (“COGS”), although the Internal Revenue Service has issued guidance strictly limiting what types of costs a taxpayer engaging in a marijuana business can allocate to COGS. Caselaw supports this narrower interpretation of COGS,

including prohibiting resellers of marijuana from including any indirect costs – costs other than the price paid for inventory plus any transportation or other necessary acquisition costs – in COGS.

Another important exception to [Code Section 280E](#) is the separate business rule recognized by the Tax Court in an early medical marijuana case. Under this rule, although Section 280E may preclude a taxpayer from taking any deductions relating to its medical marijuana sales, it can still deduct its expenses for any separate, non-trafficking trade or business. Accordingly, it is extremely important for a marijuana business to keep careful records of any other businesses it may also operate, unrelated to growing, processing, or selling marijuana.

Members of Congress have repeatedly introduced legislation to exempt marijuana businesses lawfully operating under state law from the parameters of Section 280E. Until this type of legislation is enacted, however, federal tax law will remain a potential minefield for any unwary medical marijuana businesses. It is therefore important for businesses opening under SQ 788 to seek out an experienced accountant or tax lawyer to discuss the best way to structure their business to comply with federal tax law while minimizing their tax burden.

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*If you would like to know more about how this affects your business, contact Jessica N. Cory at 405.552.2472 or [jncory@phillipsmurrah.com](mailto:jncory@phillipsmurrah.com).*