

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

Number: **201531016**

Release Date: 7/31/2015

CC:ITA:B02

PRENO-109562-15

UILC: 164.12-00, 280E.00-00

date: June 09, 2015

to: Gregory M. Hahn  
Associate Area Counsel -- Seattle (Group 1)  
Small Business/Self-Employed CC:SB:7:SEA:1

from: Thomas D. Moffitt  
Chief, Branch 2  
Office of Associate Chief Counsel  
(Income Tax and Accounting) CC:ITA:2

---

subject: Section 164, Section 280E, and the State of Washington Marijuana Excise Tax

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

How should a taxpayer who pays the State of Washington marijuana excise tax properly account for the expenditure for federal income tax purposes?

CONCLUSION

A taxpayer who paid the State of Washington marijuana excise tax should treat the expenditure as a reduction in the amount realized on the sale of the property.

FACTS

On November 6, 2012, Initiative Measure No. 502 was approved in the State of Washington. This initiative authorized the state liquor control board to regulate and tax marijuana for persons 21 years of age and older. See generally Wash. Rev. Code Ann. chapter 69.50 (West 2015). Certain acts performed by validly licensed marijuana producers, validly licensed marijuana processors, and validly licensed marijuana

retailers do not constitute criminal or civil offenses under Washington state law. Wash. Rev. Code Ann. §§ 69.50.366, 69.50.363, and 69.50.360 (West 2015).

After the passage of Initiative Measure No. 502, the State of Washington enacted excise taxes on marijuana producers, marijuana processors, and marijuana retailers. In relevant part, the law provides as follows:

Marijuana excise taxes—State liquor control board to review tax levels

(1) There is levied and collected a marijuana excise tax equal to twenty-five percent of the selling price on each wholesale sale in this state of marijuana by a licensed marijuana producer to a licensed marijuana processor or another licensed marijuana producer. This tax is the obligation of the licensed marijuana producer.

(2) There is levied and collected a marijuana excise tax equal to twenty-five percent of the selling price on each wholesale sale in this state of marijuana concentrates, useable marijuana, and marijuana-infused products by a licensed marijuana processor to a licensed marijuana retailer. This tax is the obligation of the licensed marijuana processor.

(3) There is levied and collected a marijuana excise tax equal to twenty-five percent of the selling price on each retail sale in this state of marijuana concentrates, useable marijuana, and marijuana-infused products. This tax is the obligation of the licensed marijuana retailer, is separate and in addition to general state and local sales and use taxes that apply to retail sales of tangible personal property, and is part of the total retail price to which general state and local sales and use taxes apply.

(4) All revenues collected from the marijuana excise taxes imposed under subsections (1) through (3) of this section shall be deposited each day in a depository approved by the state treasurer and transferred to the state treasurer to be credited to the dedicated marijuana fund.

(5) The state liquor control board shall regularly review the tax levels established under this section and make recommendations to the legislature as appropriate regarding adjustments that would further the goal of discouraging use while undercutting illegal market prices.

Wash. Rev. Code Ann. § 69.50.535 (West 2015).

## LAW AND ANALYSIS

Section 280E of the Code provides:

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

For purposes of § 280E, marijuana is a Schedule I controlled substance under the Controlled Substances Act. Olive v. Commissioner, 139 T.C. 19, 38 (2012), appeal docketed, No. 13-70510 (9th Cir. Feb. 11, 2013).

Section 164(a) provides:

(a) General rule.--Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

- (1) State and local, and foreign, real property taxes.
- (2) State and local personal property taxes.
- (3) State and local, and foreign, income, war profits, and excess profits taxes.
- (4) The GST tax imposed on income distributions.
- (5) The environmental tax imposed by section 59A.
- (6) Qualified motor vehicle taxes.

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income). **Notwithstanding the preceding sentence, any tax (not described in the first sentence of this subsection) which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.**

(Emphasis added.) The last sentence of section 164(a) was added by section 134(a)(2) of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, 2116, to make it clear that State, local, or foreign taxes (other than the taxes enumerated in § 164(a)) that are incurred in a trade or business or in an income-producing activity and that are connected with the acquisition or disposition of property are to be capitalized. Sleiman v. Commissioner, T.C. Memo. 1997-530, aff'd, 187 F.3d 1352 (11<sup>th</sup> Cir. 1999); Sandy Lake Rd. Ltd. P'ship v. Commissioner, T.C. Memo. 1997-295.

We interpret the State of Washington marijuana excise tax to be a tax paid or accrued in connection with the disposition of property by a trade or business. Accordingly,

pursuant to § 164(a), a taxpayer who paid the marijuana excise tax should treat the expenditure as a reduction in the amount realized on the sale of the property rather than as either a part of the inventoriable cost of that property or a deduction from gross income.<sup>1</sup> Though § 280E prohibits deductions and credits for these businesses, this excise tax is neither a deduction from gross income nor a tax credit. Consequently, § 280E does not preclude a taxpayer from accounting for this excise tax as a reduction in the amount realized on the sale of the property.

Please call Robert Basso at (202) 317-7011 if you have any questions.

---

<sup>1</sup> We note that there could be an issue of whether economic performance has occurred if a taxpayer who uses an accrual method of accounting has not paid the marijuana excise tax. See Treas. Reg. § 1.461-4(g)(6).