Note

Section 280E of the Internal Revenue Code and Medical Marijuana Dispensaries: An Interpretation Based on Statutory Purpose

*Nikola Vujcic**

Abstract

Congress enacted section 280E of the Internal Revenue Code to prohibit taxpayers engaged in the sale of illegal drugs from taking deductions on their income. Section 280E was passed after the Tax Court upheld deductions taken by a self-employed marijuana and narcotics dealer. Today, section 280E still persists in the Code and has consequently been interpreted to prohibit operators of state-sanctioned medical marijuana dispensaries from taking ordinary and necessary business deductions despite the legitimacy of their businesses. There appears to be a misalignment in the initial purpose of the statute and its current impact on medical marijuana dispensaries. Rather than await a congressional response, this Note proposes that the Supreme Court adopt a purposive interpretation of section 280E and subsequently hold that the individuals who operate state-sanctioned medical marijuana dispensaries are not prohibited from taking business expense deductions under section 162 of the Internal Revenue Code. The nature of the statute in context with the Tax Code generally suggests that the Court should interpret the provision in a manner that best aligns with the statutory purpose. Furthermore, the pertinent legislative history and social context surrounding the statute's enactment suggest that the statute's purpose was intended to punish a type of drug dealer that is readily distinguishable from state-sanctioned medical marijuana dispensaries.

---

* J.D. expected, May 2016, The George Washington University Law School; B.S., Architecture, University of Maryland.

January 2016 Vol. 84 No. 1

Table of Contents

Introduction

Section 280E of the Internal Revenue Code ("Code" or "tax code")[1] has been called a "punitive" tax by some,[2] and an "antiquated" tax by others.[3] The taxpayers who have adopted this perspec-

[1] I.R.C. § 280E (2012).

[2] Peter Hecht, *Medical Marijuana Dispensary Takes on IRS Over What It Calls 'Punitive' Taxes*, Wash. Post (Feb. 23, 2014), http://www.washingtonpost.com/politics/medical-marijuana-dispensary-takes-on-irs-over-what-it-calls-punitive-taxes/2014/02/23/25fa6458-9cd3-11e3-ad71-e03637a299c0_story.html.

[3] Matt Ferner, *The Feds Won't Legitimize Pot, But They'll Still Tax the Hell Out of It*,

tive are those who are hurt most by the provision—individuals operating medical marijuana dispensaries lawfully under state law. Their gripe with section 280E is that it imposes hundreds of thousands of dollars in taxes annually on their businesses that would normally be deductible by any other business.[4] In a recent case, a medical marijuana dispensary, Canna Care, challenged the Internal Revenue Service's ("IRS") finding that the company had failed to include $2.6 million of income over a three year period, resulting in over $800,000 in back taxes owed by the company.[5] The Commissioner of Internal Revenue ("Commissioner"), on behalf of the IRS, asserted the company had miscalculated its income when it wrongly claimed various miscellaneous business deductions that totaled up to the amount of the deficiency.[6]

The basis of the Commissioner's argument was that section 280E of the Code expressly prohibits taxpayers who operate medical marijuana dispensaries from deducting ordinary and necessary business expenses because they are engaged in the drug trafficking trade.[7] Section 280E states, "[n]o deduction . . . shall be allowed for any amount paid . . . in carrying on any trade or business if such trade or business . . . consists of trafficking in controlled substances . . . which is prohibited by Federal law or the law of any State in which such trade or business is conducted."[8] Thus, whereas a taxpayer engaged in any other type of trade can deduct from his income ordinary and necessary business expenses,[9] taxpayers operating medical marijuana businesses lawfully under state law are restricted by the language of section 280E from taking such deductions.[10]

The problem with applying section 280E against medical marijuana dispensaries is that it greatly restricts tax benefits for these businesses despite the fact that they could not have existed when Congress enacted the Code section.[11] There are only a select few sections in the

---

Huffington Post (Feb. 6, 2014, 12:59 PM), http://www.huffingtonpost.com/2014/02/06/marijuana–business–tax_n_4717589.html.

4 *See* Hecht, *supra* note 2.

5 *See id*.

6 *See id*. (identifying miscalculations in the form of deductions for employee salaries, rent, and other costs).

7 *See id*.

8 I.R.C. § 280E (2012).

9 *Id.* § 162(a) ("There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . .").

10 *Id.* § 280E. Marijuana is categorized as a Schedule I substance under the Controlled Substances Act, 21 U.S.C. § 812 (2012).

11 *See infra* Part I.A.

Code that prevent taxpayers from taking deductions for business expenses, each one responding to a well-defined policy against certain behaviors.[12] Section 280E was enacted in 1982 to prohibit illegal drug dealers from deducting business-related expenses that other taxpayers may take, regardless of the legality of their business activity.[13] Around this time, no states had yet come close to enacting legislation that would regulate a state-sanctioned medical marijuana industry.[14] Considering the growing prevalence of state-sanctioned medical marijuana dispensaries and the federal government's recent response to such businesses,[15] it is easy to understand the frustration felt by medical marijuana dispensary operators, who now have harsher tax burdens than even illegal arms dealers.[16]

Nonetheless, the Tax Court has already adopted a plain reading interpretation of section 280E in sustaining deficiencies against taxpayers who attempted to deduct ordinary and necessary business expenses incurred while operating medical marijuana dispensaries.[17] In doing so, the Tax Court has signaled to medical marijuana dispensaries that only by congressional amendment to the existing tax code will these businesses be allowed to deduct ordinary and necessary business expenses from their gross income.[18] Indeed, Congress could choose to reclassify marijuana under the Controlled Substances Act[19] or modify the tax code to allow medical marijuana dispensaries the ability to deduct ordinary business expenses. Unfortunately, the

---

12 *See infra* Part I.

13 *See infra* Part I.B.

14 *See infra* notes 76–79 and accompanying text.

15 *See infra* Part II.

16 *See* Edward J. Roche, Jr., *Federal Income Taxation of Medical Marijuana Businesses*, 66 TAX LAW. 429, 434 (2013) (noting IRS allowed illegal arms businesses to deduct commissions in a 2001 ruling).

17 *See infra* notes 119–25 and accompanying text.

18 Congress could always repeal section 280E. *See* Carrie F. Keller, Comment, *The Implications of I.R.C. § 280E in Denying Ordinary and Necessary Business Expense Deductions to Drug Traffickers*, 47 ST. LOUIS U. L.J. 157, 177–78 (2003). Congress could also explicitly exempt medical marijuana businesses from the prohibitions of section 280E. *See* Roche, *supra* note 16, at 481–82. There is also a suggestion that medical marijuana dispensaries could avoid the impact of section 280E altogether by attempting to qualify as a social welfare, tax exempt organization, under section 501(c)(4) of the Internal Revenue Code. *See* Benjamin Moses Leff, *Tax Planning for Marijuana Dealers*, 99 IOWA L. REV. 523, 534–37 (2014). *But see* Phillip T. Hackney, *A Response to Professor Leff's Tax Planning "Olive Branch" for Marijuana Dealers*, 99 IOWA L. REV. BULL. 25, 27 (2014). This Note will not address the viability or validity of these alternatives.

19 Controlled Substances Act, 21 U.S.C. §§ 801–971 (2012).

chances of these businesses seeing any legislative changes in the near future are speculative at best.[20]

This Note proposes a simpler, albeit unconventional, judicial solution to the above problem that could provide immediate relief to medical marijuana dispensaries. Specifically, this Note proposes that the Supreme Court should give greater significance to the purpose of section 280E rather than limiting its analysis to a strict reading of the statutory text and, upon doing so, reach a decision where individuals operating state-sanctioned medical marijuana dispensaries are excluded from the scope of section 280E's prohibition. The exceptional nature of section 280E in context with the tax treatment of other illegal business owners suggests that section 280E should be analyzed in a manner that considers specific congressional intent and purpose.[21] Moreover, the lack of distinction between black market drug dealers and medical marijuana operators at the time of section 280E's enactment and the legislative history accompanying section 280E tend to support a finding that the purpose of section 280E was not meant to capture individuals operating state-sanctioned medical marijuana businesses, and that it therefore should not apply to them.[22]

Part I of this Note discusses federal taxation of illegal businesses generally. This Part will demonstrate that illegal businesses are normally permitted to take ordinary and necessary business deductions unless Congress intends to prohibit specific persons whose acts violate public policy from taking those deductions. Part II then discusses the legal development of medical marijuana businesses operating lawfully under state law and the federal government's response. This Part will demonstrate that the state and federal governments have come to distinguish medical marijuana dispensaries from other illegal drug dealers because of the regulatory restrictions imposed upon these businesses. Part III analyzes situations where the Supreme Court has adopted purposive interpretations of Code sections despite clear statutory language. This Part will demonstrate that the Court has used purposive interpretations in particular situations to achieve results that match congressional intent and occasionally in response to na-

---

20 There have been a couple of recent efforts to introduce legislation that would reclassify marijuana under the Controlled Substances Act. *See* Marijuana Tax Equity Act of 2013, H.R. 501, 113th Cong. § 2 (2013); Ending Federal Marijuana Prohibition Act of 2013, H.R. 499, 113th Cong. (2013). Both of these Acts are in the early stages of the legislative process and both have received only minimal support. The scope of this Note does not cover the politics guiding marijuana regulation, nor does it advocate for any particular position.

21 *See infra* Part IV.A.

22 *See infra* Part IV.B.

tionally relevant societal issues. Part IV discusses the elements of the aforementioned proposal, principally that the Court should construe section 280E more narrowly so as to exclude medical marijuana dispensaries from the scope of the statute.

I. Tax Treatment of Individuals Engaged in Illegal Drug Trafficking and the Impetus for Enactment of Section 280E

Congress enacted section 280E in 1982 as part of the Tax Equity and Fiscal Responsibility Act of 1982[23] to institute a prohibition on business expense deductions by illegal drug traffickers.[24] To understand the effect the statute had on income taxation of illegal drug businesses, it is necessary to analyze the way in which the Code generally treats taxpayers engaged in illegal business activities and the exceptional nature of section 280E to that general treatment.

A. *Before Section 280E: Tax Treatment of Illegal Businesses Generally*

Prior to the enactment of section 280E, the tax code permitted individuals engaged in any type of illegal drug trafficking to deduct their ordinary and necessary business expenses.[25] In fact, under section 162 of the Code,[26] courts regularly allowed individuals engaged in illegal business to deduct related business expenses, such as rent and salaries, so long as the expenses met the basic requirements of section 162.[27] This notion—that the Code does not discriminate against individuals engaged in illegal business activities—has prevailed since as early as 1913, when Congress established the present income tax regime through the Revenue Act of 1913.[28] In essence, the Code was designed to treat individuals engaged in legal and illegal businesses equally in order to best reflect the taxpayers' ability to pay.[29]

---

23 Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (1982) (codified in scattered sections of 26 U.S.C. and 42 U.S.C.).

24 Wei–Chih Chiang et al., *Judicial Guidance on Medical Marijuana Tax Issues*, 92 Prac. Tax Strategies 266, 266 (2014).

25 *See* Keller, *supra* note 18, at 157–59.

26 I.R.C. § 162(a) (2012). Section 162 of the Code permits individuals to deduct "all the ordinary and necessary expenses paid or incurred . . . in carrying on any trade or business . . . ." *Id.*

27 *See* Roche, *supra* note 16, at 433–34.

28 Revenue Act of 1913, ch. 16, § 2, 38 Stat. 114, 166–81; *see* Comm'r v. Tellier, 383 U.S. 687, 691–92 (1966) (quoting 50 Cong. Rec. 3849 (1913)).

29 *See* Frank M. Keesling, *Illegal Transactions and the Income Tax*, 5 UCLA L. Rev. 26, 35 (1958).

The Supreme Court reaffirmed this notion in a 1966 tax case when it allowed a taxpayer to deduct from his taxable income the expenses incurred in pursuance of his fraudulent business activities.[30] In its opinion, the Court expressly stated that the tax code "does not concern itself with the lawfulness of the income that it taxes."[31] The Court cited specifically to the legislative history of the Revenue Act of 1913 in reaching its conclusion that the drafters of the bill did not intend to distinguish income derived from illegal activities.[32] Furthermore, the Court stated that the ordinary and necessary business deductions under section 162 of the tax code only consider the business nature of the claimed expenses, not the legitimacy of activities in which the taxpayer was engaged.[33]

The Court rejected the Commissioner's primary argument that a public policy exception should condition the deductions allowed under section 162 and that the defendant's business expenses should be disqualified accordingly.[34] The Court did not completely foreclose such an argument in the abstract, stating that a public policy exception to section 162 may be prescribed if, (1) such a decision would "frustrate sharply defined national or state policies proscribing particular types of conduct,"[35] (2) the "policies frustrated [are] national or state policies evidenced by some *governmental* declaration of them,"[36] and (3) the frustration resulting from allowing the deduction is severe and immediate.[37] An exception based on public policy grounds should be created only in "extremely limited circumstances" unless otherwise prescribed by Congress.[38] Ultimately, the Court emphasized that such

30 *See Tellier*, 383 U.S. at 689.

31 *Id*. at 691.

32 *See id*. at 691–92. During a Senate floor meeting preceding the enactment of the income tax bill, the Senator in charge of the bill was quoted saying, that

> [T]he object of this bill is to tax a man's net income; that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses. It is not to reform men's moral characters; that is not the object of the bill at all. . . . The law does not care where he got [his income] from, so far as the tax is concerned . . . .

Id. (first alteration in original) (quoting 50 CONG. REC. 3849 (1913)).

33 *See id.* at 691.

34 *Id*. at 690–91.

35 *Id*. at 694 (quoting Comm'r v. Heininger, 320 U.S. 467, 473 (1943)).

36 *Id*. (quoting Lilly v. Comm'r, 343 U.S. 90, 97 (1952)).

37 *See id*. (citing Tank Truck Rentals, Inc. v. Comm'r, 356 U.S. 30, 35 (1958)); *cf.* Bob Jones Univ. v. United States, 461 U.S. 574, 593–96 (1983) (stating public policy exception could be read into Code sections if straightforward application of provision would violate fundamental national policy).

38 *Tellier*, 383 U.S. at 693–94.

exceptional circumstances were not present in the case in dispute and that such deductions could be prohibited only if Congress were to pass legislation affirmatively barring the deductions.[39]

In the few cases where the public policy exception arose as an argument against allowing deductions for illegal business expenses, the Court focused primarily on the nature of the payments of the expenses rather than the legality of the conduct giving rise to them.[40] For example, in *Tank Truck Rentals, Inc. v. Commissioner*,[41] the Court prevented petitioner from deducting as business expenses penalties incurred as a result of illegal activities because allowing such deductions would immediately frustrate the policy of imposing the penalties in the first place.[42]

The same principle has been emphasized in drug cases where the taxpayer attempted to deduct from his income the forfeiture of business assets resulting from a seizure.[43] In *Wood v. United States*,[44] the Fifth Circuit prohibited the petitioner from deducting from his income forfeitures of real property following a government seizure of his assets associated with his drug dealing business.[45] The court deduced that the intent of the forfeiture statute was essentially to punish drug dealers and that allowing the petitioner to deduct from his income the value of the property lost would contravene the purpose of the forfeiture statute altogether.[46]

The analysis of these cases demonstrates that a taxpayer who is merely engaged in a business activity that violates federal or state law may nonetheless be able to deduct ordinary and necessary business expenses.[47] The cases suggest that a taxpayer will be denied deduc-

---

39 *Id.* at 693–94 ("[D]eductions 'are a matter of grace and Congress can, of course, disallow them as it chooses.'" (quoting Comm'r v. Sullivan, 356 U.S. 27, 28 (1958))).

40 *See* Charles A. Borek, Comment, *The Public Policy Doctrine and Tax Logic: The Need for Consistency in Denying Deductions Arising From Illegal Activities*, 22 U. BALT. L. REV. 45, 54 (1992).

41 Tank Truck Rentals, Inc. v. Comm'r, 356 U.S. 30 (1958).

42 *Id.* at 31–32.

43 The cases that involve such factual scenarios arose under the applicability of the public policy exception to section 165 deductions for losses associated with business activities, rather than section 162 deductions for ordinary and necessary business expenses. I.R.C. § 165(a) (2012). This Note does not attempt to differentiate the applicability of the public policy exception with respect to these two distinct deductions, but rather hopes to emphasize how the courts have selectively imposed exceptions to business-related deductions when such deductions would frustrate state or federal policy.

44 Wood v. United States, 863 F.2d 417 (5th Cir. 1989).

45 *Id.* at 421–22.

46 *Id.*

47 *See, e.g.*, Comm'r v. Tellier, 383 U.S. 687, 694–95 (1966).

tions on ordinary and necessary business expenses if the taxpayer is engaged in illegal business activities *and*, additionally, if the deduction itself contravenes a statute intended to punish the taxpayer monetarily, such that allowing the deduction would severely soften the punitive nature of the statute.[48]

In response to the evolving judicially-created public policy exception, Congress acted by codifying aspects of the exception as part of the Tax Reform Act of 1969.[49] In doing so, Congress expressly prohibited particular types of section 162 deductions that, if allowed, would contravene public policy.[50] This had the immediate effect of significantly abrogating the public policy exception under section 162, signaling to the courts that Congress would expressly disallow deductions for business expenses where it deemed appropriate.[51]

Regardless of this shift, the general rule regarding ordinary and necessary business expense deductions remains that section 162 does not discriminate against certain types of business expenses based on the means by which taxpayers earn their income.[52] The exceptions to that rule continued to prohibit deductions for expenses resulting out of illegal business activities that frustrate sharply defined public policy forbidding that conduct.[53] Initially, Congress limited the prohibited business expense deductions to kickbacks and bribes,[54] fines and penalties imposed on taxpayers for engaging in illegal activities,[55] and treble damage payments related to criminal antitrust convictions.[56] These specific expenses were to be treated as an all-inclusive list because other aspects of public policy were not "sufficiently . . . defined to justify the disallowance of deductions [under section 162]."[57]

---

48 *See, e.g.*, Tank Truck Rentals, Inc. v. Comm'r, 356 U.S. 30, 36–37 (1958).

49 *See* Tax Reform Act of 1969, Pub. L. No. 91-172, § 902, 83 Stat. 487, 710 (codified as amended at I.R.C. § 162(c), (f), (g) (2012)).

50 *See id.*; *see also* S. Rep. No. 91-552, at 273–275 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2310–11.

51 *See* Borek, *supra* note 40, at 56; *see also* Treas. Reg. § 1.162-1(a) (1975) ("A deduction for an expense paid or incurred after December 30, 1969, which would otherwise be allowable under section 162 shall not be denied on the grounds that allowance of such deduction would frustrate a sharply defined public policy.").

52 *See* Keesling, *supra* note 29, at 35.

53 *See* S. Rep. No. 91-552, at 273–75, *reprinted in* 1969 U.S.C.C.A.N. at 2310–11.

54 I.R.C. § 162(c) (2012).

55 *Id.* § 162(f).

56 *Id.* § 162(g).

57 S. Rep. No. 91-552, at 274, *reprinted in* 1969 U.S.C.C.A.N. at 2311.

B. Enactment of Section 280E

Section 280E was enacted thirteen years after Congress first barred individuals from deducting certain illegal business expenses.[58] The enactment of section 280E came as a direct response to *Edmondson v. Commissioner*,[59] which had been decided before the United States Tax Court one year earlier.[60] In that case, the court allowed the petitioner to deduct business expenses under section 162 even though the petitioner's occupation was dealing drugs.[61] The petitioner, a self-employed drug dealer who sold amphetamines, cocaine, and marijuana out of his apartment, received a deficiency notice from the IRS after he filed his 1974 tax return with deductions for various miscellaneous business expenses, including transportation costs, equipment purchases, telephone costs, food, and a portion of the rent of his apartment, which was his sole place of business.[62] The petitioner also deducted the cost of goods sold from his income, which totaled $105,300.[63] The IRS disallowed all of the miscellaneous business expenses reported by the petitioner, as well as $30,341.69 from the reported costs of goods sold.[64]

The court ultimately disagreed with the IRS's determination as to the deductibility of the claimed business expenses and costs of goods sold.[65] The court first established that the petitioner's valuation of costs of goods sold appeared genuine and was supported substantially by his own testimony.[66] The court further permitted the petitioner to deduct those miscellaneous business exceptions that were related to his business activities.[67] As for the rent of his apartment, the court determined that a portion of the rent paid could be deducted as a business expense because the petitioner provided sufficient evidence that his apartment served as his place of business.[68]

---

58 Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 351, 96 Stat. 324, 640 (codified at I.R.C. § 280E).

59 Edmondson v. Comm'r, 42 T.C.M. (CCH) 1533 (1981).

60 *Id.* at 1533; *see also* S. Rep. No. 97-494, at 309 (1982), *reprinted in* 1982 U.S.C.C.A.N. 781, 1050.

61 *See Edmondson*, 42 T.C.M. (CCH) at 1534–36.

62 *See id.* at 1534.

63 *Id.*

64 *Id.*

65 *Id.* at 1536.

66 *Id.* at 1535.

67 *Id.*

68 *Id.* Notably, the Tax Court did not mention whether the allowance of deductions from business expenses incurred by taxpayers engaged in illegal business activities would go against public policy. *See id.* at 1535–36. Presumably, the Tax Court did not address the issue because

Immediately following the decision in *Edmondson*, Congress responded by drafting section 280E of the tax code, as part of the Tax Equity and Fiscal Responsibility Act of 1982,[69] to institute a prohibition on business expense deductions available to illegal drug traffickers.[70] The enactment of this provision marked the end of equal treatment for taxpayers engaged in illegal drug dealing.[71] The congressional intent of the provision was concisely expressed in the Senate Report that accompanied the bill prior to its passage.[72] In that Senate Report, the Senate Finance Committee first explicitly acknowledged the result in *Edmondson*.[73] It also made clear that the Code had already imposed restrictions on deductions for specifically enumerated activities under section 162.[74] The Committee's Report identified drug dealing as a contravention of sharply defined public policy, determining that individuals engaged in drug trafficking should not be afforded the benefit of business expense deductions, particularly when the United States and its citizens lose billions of dollars each year to those drug dealers.[75]

II. Post-280E: Expansion of State-Sanctioned Medical Marijuana Programs

At the time that section 280E was passed into law, there existed no distinction among the types of drug dealing activities that Congress could have contemplated when it created section 280E. Yet in the last three decades, nearly half of the states have given marijuana distributed for medical purposes a characterization wholly distinct from ma-

---

the Commissioner likely did not raise the argument to rebut the petitioner's claimed section 162 business expenses. This is likely because the Treasury had previously interpreted the Tax Reform Act of 1969 as effectively abrogating any common law public policy exception. *See* Treas. Reg. §1.162-1(a) (1975). If such business expenses were to be nondeductible, Congress would have to act to impose exceptions to the basic laws regarding business-related deductions. *See id.*

69 Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 351, 96 Stat. 324, 640 (codified at I.R.C. § 280E).

70 *See* Chiang et al., *supra* note 24, at 266.

71 *See id.* (recognizing section 280E explicitly prohibits those engaged in business with illegal drugs from taking business deductions under section 162).

72 Keller, *supra* note 18, at 164–65.

73 *See* S. Rep. No. 97-494, at 309 (1982), *reprinted in* 1982 U.S.C.C.A.N. 781, 1050.

74 *See id.*

75 *Id.* ("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. . . . *All deductions and credits* for amounts paid or incurred in the illegal trafficking in drugs listed in the Controlled Substances Act are disallowed." (emphasis added)).

rijuana distributed recreationally, as reflected through their state laws.[76] Though the federal government has not adopted any laws per se that distinguish medical marijuana as a drug deserving its own federal regulation, there is an apparent and increased acceptance by the Justice Department, and even Congress, in allowing these state-authorized programs to operate unhindered under State regulation.[77]

A. *History of Medical Marijuana Legalization by the States*

The states' first attempts at decriminalizing medical marijuana began as early as 1978, but to a more or less ineffective and futile end.[78] Many states attempted to pass laws throughout the 1980s that recognized the medical value of marijuana, though without providing patients with any legitimate legal protection.[79] For example, some states passed laws that made possession of marijuana illegal unless it had been prescribed by a medical doctor;[80] however, such laws were ineffective because doctors could still be criminally charged for prescribing marijuana and pharmacies could not dispense medically-prescribed marijuana.[81]

The notion that the states could sanction medical marijuana programs despite federal laws criminalizing marijuana began to gain traction in the mid-1990s when California voters approved Proposition 215 and the state subsequently enacted the Compassionate Use Act of 1996.[82] The Act decriminalized, under California law, the cultivation and possession of medical marijuana under certain conditions.[83] Notably, the law did not attempt to rely on or garner support from the federal government, but stated rather coyly that it intended "[t]o encourage the federal and state governments to implement a plan to provide for the safe and affordable distribution of marijuana to all patients in medical need of marijuana."[84]

The Compassionate Use Act does not purport to protect dispensaries and users of medical marijuana from federal prosecution and

---

76 *See infra* Part II.A.

77 *See infra* Part II.B.

78 *See* Karen O'Keefe, *State Medical Marijuana Implementation and Federal Policy*, 16 J. Health Care L. & Pol'y 39, 43 (2013).

79 *See id.*

80 *See, e.g.*, *id.* (citing Va. Code Ann. § 18.2-250.1 (2009)).

81 *Id.*

82 Cal. Health & Safety Code § 11362.5 (West 2014); *see also* O'Keefe, *supra* note 78, at 44 (describing notion of state sanctions of medical marijuana programs).

83 *See* O'Keefe, *supra* note 78, at 44.

84 Health & Safety § 11362.5(b)(1)(C).

enforcement under the Controlled Substances Act.[85] In *United States v. Oakland Cannabis Buyers' Cooperative*,[86] the Supreme Court rejected the contention that there is an implied medical necessity exception under the Controlled Substances Act, thus establishing that statutes like Proposition 215 do not abrogate the federal government's ability to prosecute under federal law.[87] Furthermore, in *Gonzalez v. Raich*,[88] the Court held that the federal government has the power to regulate marijuana sales and prosecute offenders even if the individual's state has enacted laws that permit marijuana to be used for medical purposes.[89] Even so, appellate courts in California have nonetheless found that states may decriminalize medical marijuana under state law and may not be compelled by the federal government to refrain from doing so.[90]

Since California voters passed Proposition 215 in 1996, a total of twenty-three states and the District of Columbia now have passed legislation amending the states' laws on medical marijuana to allow for public medical marijuana programs.[91] The rate at which the states have enacted legislation has been increasing drastically in recent years; of the twenty-three states that have enacted legislation sanctioning medical marijuana programs, seven of them had only done so in the last four years.[92]

Of the states that have enacted laws decriminalizing medical marijuana, sixteen of them and the District of Columbia currently provide some type of regulatory scheme that allows for medical marijuana dispensaries to operate within the state lawfully.[93] California, for example, enacted legislation that permitted cities to pass ordinances regulating the operation of medical marijuana dispensaries.[94]

---

85 *See* O'Keefe, *supra* note 78, at 45.

86 United States v. Oakland Cannabis Buyers' Coop., 532 U.S. 483 (2001).

87 *See id.* at 486.

88 Gonzales v. Raich, 545 U.S. 1 (2005).

89 *See id.* at 22.

90 *See, e.g.*, Cnty. of San Diego v. San Diego NORML, 81 Cal. Rptr. 3d 461, 483 (Cal. Ct. App. 2008) ("Congress does not have the authority to compel the states to direct their law enforcement personnel to enforce federal laws.").

91 *See State Medical Marijuana Laws*, NAT'L CONF. ST. LEGISLATURES, http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx (last visited Jan. 10, 2016). The states that have some form of medical marijuana legalization are Alaska, Arizona, California, Colorado, Connecticut, Delaware, Hawaii, Illinois, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, Oregon, Rhode Island, Vermont, and Washington. *See id.*

92 *See id.*

93 *See id.*

94 *See* O'Keefe, *supra* note 78, at 49.

Such a regulatory scheme became ineffective, however, once the federal government began interfering with localities that had approved medical marijuana dispensary regulations.[95]

Nonetheless, in 2007, New Mexico dared to become the first state to enact a statute that regulated large-scale medical marijuana dispensaries,[96] and in 2009 finally began licensing producers and dispensaries.[97] States that enacted medical marijuana programs since 2009 have included regulations governing distribution efforts similar to that of New Mexico, while others with existing laws added dispensary provisions to their existing medical marijuana legislation.[98] Such laws permit states to license producers and distributors of medical marijuana so long as they adhere to the strict regulatory laws established by the state legislature.[99]

States that have established comprehensive regulatory schemes for licensing medical marijuana dispensaries seem to have effectively demonstrated to the federal government their intent to ensure exclusion of drug dealers acting outside the scope of decriminalized conduct.[100] In fact, the typical licensing and operating requirements promulgated through state regulation are generally quite detailed and burdensome on producers.[101] Given the recent federal response to these state programs, it appears that the states have carved out a distinct legal niche from what is otherwise an illegal market.[102]

B. *Federal Response to State Medical Marijuana Programs*

Initially, the federal response to these newly-enacted state laws was to prosecute violators of the Controlled Substances Act regardless of the existing state law.[103] Not surprisingly, federal prosecutors could successfully enforce the Controlled Substances Act under federal law without any regard to the conflicting state law.[104] Despite this federal

95 *See id.*

96 Lynn and Erin Compassionate Use Act, N.M. Stat. Ann. §§ 26-2B-1 to -7 (Supp. 2007).

97 *See* O'Keefe, *supra* note 78, at 50.

98 *See id.* at 51.

99 *See, e.g.*, § 26-2B-5.

100 *See* Memorandum from James M. Cole, Deputy Attorney Gen., to U.S. Attorneys 2–3 (Aug. 29, 2013) [hereinafter Cole Mem.], http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf.

101 *See, e.g.*, N.M. Code R. §§ 7.34.4.1–.21 (LexisNexis 2015).

102 *See infra* Part II.B.

103 *See, e.g.*, United States v. Cannabis Cultivators Club, 5 F. Supp. 2d 1086, 1092–93 (N.D. Cal. 1998).

104 *See* United States v. Oakland Cannabis Buyers' Coop., 532 U.S. 483, 486 (2001).

reaction, states continued to pass legislation decriminalizing medical marijuana throughout the mid-2000s.[105]

The first big advancement of state regulatory laws regarding the operation of medical marijuana dispensaries occurred when Deputy Attorney General Ogden of the Department of Justice ("DOJ") issued a Memorandum in 2009 on the relative priority of prosecuting state-sanctioned medical marijuana dispensaries.[106] The Memorandum stated in part that federal prosecutors "should not focus federal resources in [states that have legalized medical mariujana] on individuals whose actions are in clear and unambiguous compliance with existing state laws providing for the medical use of marijuana."[107] Since prosecutors were not going to make enforcement of federal marijuana laws a priority in states that issued enforceable medical marijuana laws, all states that created medical marijuana programs after 2009 made sure to closely regulate distribution at the state level.[108] This allowed states to move beyond mere decriminalization and to institute medical marijuana distribution programs so that registered patients could have access to the drug.[109]

In 2013, the DOJ issued another memorandum that was intended to clarify and limit the message conveyed in the 2009 Memorandum.[110] In summary, it stated that individuals who use marijuana to alleviate a serious medical condition and dispensaries that distribute solely to care for those seriously ill patients would not be an enforcement priority for federal prosecutors.[111] The 2013 Memorandum essentially distinguishes the relative enforcement priority of medical marijuana users and dispensaries that are in strict compliance with the state regulations and requirements, and those users and dispensaries that violate state regulations and other federal policy.[112]

---

105 *See State Medical Marijuana Laws*, *supra* note 91.

106 *See* Memorandum from David W. Ogden, Deputy Attorney Gen., to Selected U.S. Attorneys 1 (Oct. 19, 2009), http://www.justice.gov/sites/default/files/opa/legacy/2009/10/19/medical-marijuana.pdf.

107 *Id.* at 1–2.

108 *See* O'Keefe, *supra* note 78, at 51–52.

109 *See id.* at 53.

110 *See* Cole Mem., *supra* note 100, at 1.

111 *See id.* at 2–3.

112 *See id.* The 2013 Memo lists eight priority marijuana-related items that it states will be the focus of federal enforcement resources, regardless of state law. These priority items include: preventing distribution of marijuana to minors, preventing revenue from reaching criminal groups, preventing transport of marijuana to states where it is not legal, preventing state-sanctioned operations from serving as a cover for trafficking other drugs, preventing violence in connection with marijuana distribution, preventing users from driving while intoxicated, preventing the growth of marijuana on public lands, and preventing possession or use of mari-

The most recent advancement in medical marijuana legalization reform occurred in December of 2014, when Congress included a provision in its 2015 Fiscal Year spending bill that "prohibits the Department of Justice from preventing certain States from implementing State laws regarding the use of medical marijuana."[113] This provision, known as the Farr-Rohrabacher Amendment, effectively blocks the Drug Enforcement Agency ("DEA") from hindering state programs that regulate medical marijuana dispensaries.[114] It may also prohibit the federal government from prosecuting medical marijuana growers and distributors who are in compliance with state regulations; yet this remains unclear.[115] Though the language of the provision is ambiguous as to its effect on dispensaries and patients, and though the law is only active for the duration of the fiscal year, the provision does at least signify that the federal government may allow states to regulate the medical marijuana industry so long as they institute strict enforcement standards of their own that protect the public against noncompliant businesses.[116]

Even though the federal government maintains that medical marijuana is illegal under the Controlled Substances Act, it has acknowledged a cognizable distinction with respect to federal enforcement between dispensaries that operate in compliance with state law and other entities that do not.[117] The key feature that federal officials have accepted is that medical marijuana dispensaries are required by state law to follow strict regulatory schemes, placing the burden of enforcement on the states themselves.[118]

---

juana on federal property. *Id.* at 1–2. In respect to medical marijuana operations, "[t]he Department's guidance in this memorandum rests on its expectation that states and local governments . . . will implement strong and effective regulatory and enforcement systems that will address the threat those state laws [authorizing medical marijuana programs] could pose to public safety, public health, and other law enforcement interests." *Id.* at 2.

113 160 Cong. Rec. H9351 (daily ed. Dec. 11, 2014) (statement of Rep. Rodgers); *see also* Staff of H. Rules Comm., 113th Cong., Text of H. Amendment to the S. Amendment to H.R. 83, at 213–14 (Comm. Print 2014).

114 *See* Jodi L. Avergun et al., *Clearing the Smoke Around the Farr-Rohrabacher Amendment*, Law360 (Mar. 10, 2015, 12:35 PM), http://www.law360.com/articles/628782/clearing–the–smoke–around–the–farr–rohrabacher–amendment.

115 *See id.* The Amendment was placed at issue in a recent case decided by the U.S. District Court for the Eastern District of Washington. *Id.* (citing United States v. Firestack-Harvey, No. 13-CR-0024-TOR-1 (E.D. Wash. Feb. 12, 2015)). The decision did not directly interpret the Amendment, but it "strongly suggests that both the district court and government believe the amendment prohibits the [DOJ] from using its fiscal year 2015 funds to prosecute growers and distributors of medical marijuana whose conduct is in compliance with state law." *Id.*

116 *See id.*

117 *See, e.g.*, Cole Mem., *supra* note 100, at 2–3.

118 *See id.* at 2.

III. Purposive Statutory Interpretation in Supreme Court Tax Jurisprudence

Even if there has been an implicit shift in federal government's attitude towards medical marijuana dispensaries, a literal application of Section 280E unquestionably encompasses medical marijuana dispensaries under its prohibition against deductions for ordinary and necessary business expenses because marijuana is classified as a prohibited Schedule I substance.[119] In fact the United States Tax Court has already held twice that Section 280E does not exempt medical marijuana dispensaries from the statute's prohibition, relying on the plain language of the statute.

In *Californians Helping to Alleviate Medical Problems, Inc. v. Commissioner* (*CHAMP*),[120] the Tax Court held that section 280E prohibited petitioners, taxpayers who operated a business that served partially as a medical marijuana dispensary, from deducting from their incomes the ordinary and necessary business expenses related to the medical marijuana operation.[121] The Court stated that the legislative history of the provision suggested that Congress intended to prohibit businesses engaged in the sale of controlled substances from taking business expense deductions related to their illegal activities.[122] The Court rejected petitioner's argument that medical marijuana dispensaries are not engaged in "trafficking" of controlled substances, which petitioner argued as being a distinguishing characteristic between itself and other illegal drug dealing operations.[123]

Similarly, in *Olive v. Commissioner*,[124] the Tax Court again held that the section 280E deductions for ordinary and necessary business expenses incurred in operation of petitioner's business, a medical marijuana dispensary, were impermissible because petitioner was engaged in a business that trafficked a controlled substance.[125] Both this case and the *CHAMP* decision reveal that the Tax Court is unwilling to entertain arguments that: (1) medical marijuana is not a controlled

---

119 I.R.C. § 280E (2012) (classifying prohibited deductions based on the status of the type of drug sold under the Controlled Substances Act).

120 Californians Helping to Alleviate Med. Problems, Inc. v. Comm'r (*CHAMP*), 128 T.C. 173 (2007).

121 *See id*. at 182.

122 *See id*.

123 *See id*. (recognizing that "traffic" is defined as "to engage in commercial activity: buy and sell regularly" (quoting Webster's Third New International Dictionary 2423 (Philip Babcock Gove & Noah Webster eds., 2002))).

124 Olive v. Comm'r, 139 T.C. 19 (2012).

125 *Id*. at 38.

substance; (2) medical marijuana dispensaries are not "trafficking" a controlled substance; or (3) section 280E should be read in a way such that it does not encompass those businesses operating lawfully under state law.[126]

Though the analysis in both cases is sound in most respects, neither decision considered the purpose of section 280E and whether applying section 280E against individuals engaged in legitimate state businesses corresponds with that purpose. It is true that federal statutes codify the American tax law system and that written law governs tax enforcement.[127] Yet no matter the amount of precise language Congress tries to draft into Code sections, the Tax Court and the Supreme Court have always found it necessary to provide some degree of interpretation to those enacted statutes.[128] According to the IRS, the tax decisions issued by the Supreme Court are of parallel weight with the Code, making the Supreme Court a primary institution in shaping the federal tax law.[129]

An analysis of Supreme Court tax decisions shows that the Supreme Court tends generally to interpret Code sections to carry out congressional intent and purpose.[130] In some cases, this means that the Court will read beyond the plain meaning of a Code section to issue a decision that comports with the Court's interpretation of the purpose of the statute.[131] Often the Supreme Court does this to ensure that the substance of a Code section controls if there is disconnect between the language of the Code section and the apparent congressional purpose in enacting the statute.[132]

When the language of a Code section and the apparent purpose of the Code section conflict, the Supreme Court has at times chosen to interpret the language of the statute so as to arrive at a result that more closely reflects the statute's purpose.[133] Often, the Court deviates from literal readings of the statutory language when it appears

---

126 *See id.* at 38; *CHAMP*, 128 T.C. at 182.

127 *See* I.R.C. §§ 1–9834 (2012).

128 *See* Jasper L. Cummings, Jr., The Supreme Court's Federal Tax Jurisprudence 74 (2010). Though both the Tax Court and Supreme Court play large roles in the development of judicially-created tax doctrine, this Note will only analyze the development of tax doctrine developed through the Supreme Court and its interpretative techniques.

129 *Id.* at 75–76 (citing IRS, Internal Revenue Manual 4.10.7.2.9.8 (2010)).

130 *Id.* at 5.

131 *See id.* at 86.

132 *See id.*

133 *See* Lawrence Zelenak, *Thinking About Nonliteral Interpretations of the Internal Revenue Code*, 64 N.C. L. Rev. 623, 638 (1986); *see also* Deborah A. Geier, *Interpreting Tax Legislation: The Role of Purpose*, 2 Fla. Tax Rev. 492, 493 (1995) ("[T]ax law has a rich history of

that Congress has not specifically considered a situation and, consequently, a literal interpretation of the statute would likely lead to a result contrary to Congress's purpose for enacting the statute.[134] The Supreme Court has adopted purposive interpretations of Code sections even when the decision of the Court cannot be reconciled with a literal reading of the statutory language.[135] An analysis of those cases shows that the Court has done this in situations to achieve results that match congressional intent and occasionally in response to nationally-relevant societal issues.[136]

A. *Application of Statutory Purpose Towards Achieving Tax Results that Match Congressional Intent*

The Supreme Court often makes some reference to the legislature's purpose in enacting a tax statute prior to reaching its decision.[137] The degree of importance that the Court attributes to legislative intent varies by case, likely because of the varying clarity of purpose that can be discerned from the particular statute.[138]

One way in which the Court has derived the legislature's purpose is by focusing on tax logic.[139] For example, in *Commissioner v. Tufts*,[140] the Supreme Court based its final decision on tax logic rather than a literal reading of the statute.[141] The issue was whether a taxpayer must include the unpaid value of nonrecourse debt[142] after the sale of the mortgaged property as realized income when that unpaid amount exceeded the fair market value of the property sold.[143] The Court held that the sale of property generated realized income at the full value of the nonrecourse mortgage, even though a literal reading

---

nonliteral interpretation in order to avoid results that one person or another has considered to be inconsistent with the purpose of the statute as a whole.").

134 *See* Zelenak, *supra* note 133, at 639.

135 *See id.* at 649, 651.

136 *See infra* Parts III.A, III.B.

137 *See* Michael Livingston, *Practical Reason, "Purposivism," and the Interpretation of Tax Statutes*, 51 TAX L. REV. 677, 689–90 (1996).

138 *See* William N. Eskridge, Jr., *Dynamic Statutory Interpretation*, 135 U. PA. L. REV. 1479, 1545 (1987) (recognizing flaws with certain legislative interpretation approaches based on differences between individual statutes).

139 *See* Livingston, *supra* note 137, at 690.

140 Comm'r v. Tufts, 461 U.S. 300 (1983).

141 *See* Livingston, *supra* note 137, at 692–93 (citing *Tufts*, 461 U.S. at 312–13).

142 Nonrecourse debt limits the lender's recovery options to the collateral secured on the loan; the lender may not recover personally from the debtor. *Recourse vs. Nonrecourse Debt*, INTERNAL REVENUE SERV., http://apps.irs.gov/app/vita/content/36/36_02_020.jsp (last visited Jan. 12, 2016).

143 *Tufts*, 461 U.S. at 301–02.

of the pertinent Code section could not support such a finding.[144] Rather than relying on the language of provision, the Justices reasoned that the amount should logically constitute taxable income within the meaning of the Code section as Congress intended it.[145] The Court appeared to resolve the issue on the grounds that in order to fulfill the purpose of the statute, which was to account properly for a taxpayer's realized income, it would be only logical to treat the mortgagor's released obligation in full as realized income.[146]

One explanation for the Court's departure from a literal application of the clear statutory language in *Tufts* is that such an application would not adequately capture all income that Congress likely intended to capture, resulting in underrecognition of income and a disproportionate tax outcome.[147] Here, the Court chose to give greater weight to statutory purpose rather than the statute's language itself because ignoring such purpose would lead to an unjust outcome and would create potential for abuse.[148] The unjustness that could arise out of a contrary outcome is the risk of horizontal inequity—that an individual who sells a piece of property financed by a nonrecourse loan may be able to avoid paying a percentage of tax liability another person in the exact same position may ultimately have to pay.[149]

In *Hillsboro National Bank v. Commissioner*,[150] the Supreme Court again chose to resolve a tax dispute using a purposive interpretation of a Code section, focusing on the more informative legislative history of the Code section rather than its language.[151] The Court had

---

144 *See Tufts*, 461 U.S. at 312; *see also* Zelenak, *supra* note 133, at 625. The statute defines "amount realized" from a disposition of property as "the sum of any money received plus the fair market value of the property (other than money) received." I.R.C. § 1001(b). However, the Court does not explain how this definition would encompass the "full amount of a nonrecourse mortgage in excess of the fair market value of the property." Zelenak, *supra* note 134, at 625. Professor Zelenak believes that the Court likely could not reconcile its decision with the language of the statute, thus choosing not to acknowledge the apparent conflict. *Id.* at 625–26.

145 *See Tufts*, 461 U.S. at 312 ("When the obligation is canceled, the mortgagor is relieved of his responsibility to repay the sum he originally received and thus realizes value to that extent within the meaning of [the Code section]. . . . [I]t is as if the mortgagor first had been paid with cash borrowed by the third party from the mortgagee on a nonrecourse basis, and then had used the cash to satisfy his obligation to the mortgagee.").

146 *See* Zelenak, *supra* note 133, at 625.

147 *See* Cummings, *supra* note 128, at 130.

148 *See* Livingston, *supra* note 137, at 694.

149 *See* Robert Plotnick, *A Comparison of Measures of Horizontal Inequity*, *in* Horizontal Equity, Uncertainty, and Economic Well-Being 239, 239 (Martin David & Timothy Smeeding eds., 1985).

150 Hillsboro Nat'l Bank v. Comm'r, 460 U.S. 370 (1983).

151 *See id.* at 402.

to determine whether the tax benefit rule required a corporation to include in its income the value of liquidated cattle feed on which it had previously taken a business expense deduction.[152] The taxpayers argued that they were not required to include the liquidated goods as part of their income, relying on a nonrecognition statute.[153] The cited Code section stated, "no gain or loss shall be recognized to a corporation on the distribution of property in partial or complete liquidation."[154] A literal reading would seem to suggest that the liquidated cattle feed would not qualify as recognized income;[155] even so, the Court emphasized the importance of reading beyond the mere language of the statute "to inquire whether this is the sort of gain that goes unrecognized under [the Code section]."[156] The Court's analysis included a review of the legislative history of the section and its meaning within the context of the Code.[157] After conducting this analysis, the Court held that the tax benefit rule disqualified the taxpayer from excluding the gains from liquidation from taxable income, despite what the statute seemed to say.[158]

An analysis of *Hillsboro National Bank* yields a similar rationale to that of *Tufts*—had the Court chosen to adopt a literal reading of the statutory language, it would have created a potential avenue for taxpayers to avoid recognizing income in situations where the income should be recognized.[159] Rather than relying on the clear statutory language, the Court recognized inconsistency between the statutory language and its legislative history, choosing to adopt the interpretation that best corresponded with the purpose of the statute in the context of the Code generally.[160]

These two cases demonstrate a willingness by the Court to interpret tax statutes based on extrinsic factors when it believes that the language of what may be fairly characterized as an unambiguous statute is either underinclusive, as in *Tufts*, or overinclusive, as in *Hills-*

---

152 *Id.* at 374–76.

153 *Id.* at 375–76.

154 *Id.* at 375 & n.4 (citing I.R.C. § 336 (1976)).

155 Zelenak, *supra* note 133, at 625.

156 *Hillsboro Nat'l Bank*, 460 U.S. at 397; *see also id.* at 398 ("Despite the breadth of the nonrecognition language in § 336, the rule of nonrecognition clearly is not without exception. . . . Even in the absence of countervailing statutory provisions, courts have never read the command of nonrecognition in § 336 as absolute.").

157 *Id.* at 397 n.33 (focusing on the underlying contextual background during the enactment of the statute and its place within the framework of the Code).

158 *Id.* at 402.

159 *See id.*

160 *See id.*

boro National Bank, of the legislature's purpose in enacting the statute.[161]

B. Using Legislative Purpose to Achieve Decisions that Respond to Greater Societal Issues

The Supreme Court has also afforded greater weight to a tax statute's purpose when a literal reading of the statute would yield a result contrary to well-established public policy. In *Bob Jones University v. United States*,[162] the issue raised was whether to limit the types of organizations that could apply for tax-exempt status under section 501(c)(3) of the Code based on the beliefs of the organization.[163] The institution that sought to receive the benefits of tax-exemption had promulgated racially discriminatory rules that affected admissions and student conduct.[164] Specifically referencing the language of the statute, the institution believed that it clearly fell within the statutory requirements of section 501(c) for tax exemption as a university "organized and operated exclusively for religious, charitable . . . or educational purposes."[165]

The Supreme Court responded to the taxpayer's argument by stating, "[i]t is a well-established canon of statutory construction that a court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute."[166] Following this canon, the Court interpreted the statute as limiting its exception to those institutions that do not thwart public policy.[167] In effect, the Court supplemented the statutory requirements of section 501(c)(3) by adding an additional public policy requirement:

> History buttresses logic to make clear that, to warrant exemption under § 501(c)(3), an institution must fall within a category specified in that section *and* must demonstrably serve and be in harmony with the public interest. The institution's purpose must not be so at odds with the common community conscience as to undermine any public benefit that might otherwise be conferred.[168]

---

161 *See* Zelenak, *supra* note 133, at 625.

162 Bob Jones Univ. v. United States, 461 U.S. 574 (1983).

163 *See id.* at 577.

164 *See id.* at 580–81.

165 *Id.* at 585–86 (alteration in original) (quoting I.R.C. § 501(c)(3)).

166 *Id.* at 586.

167 *See id.* at 591–92.

168 *Id.* (emphasis added) (footnote omitted).

The Court then went on to hold that "racial discrimination in education violates deeply and widely accepted views of elementary justice,"[169] and that, as a result, the taxpayer institution could not qualify for tax-exempt status under section 501(c)(3).[170] Arguably, the Supreme Court adopted a highly purposive approach in this situation because of the sensitivity of the issues presented and in light of historical context.[171] Because the case involved an exceptional circumstantial detail—the public's reformed attitudes towards racism—the value of the purposive statutory interpretation techniques adopted in this case is somewhat limited.[172]

Nevertheless, the decision in *Bob Jones University* exemplifies how the Court may be influenced in part by major social and ideological changes.[173] For example, the Court used a purposive analysis in *Bob Jones University* in order to justify imposing a public policy requirement on the unambiguous language of section 501(c)(3),[174] even though there were sufficiently valid reasons raised by the dissent to hold otherwise.[175] This case could have easily come out the other way had the Court focused on the text of the statute, and Congress could have remedied the situation by amending the statute to effectively create a codified public policy requirement.[176] Yet the Court opted instead to interpret the statute nonliterally, which not only speaks to the Court's ideology, but its ability to use purposive interpretation to promote social reform.[177]

This analysis is not unique to the *Bob Jones University* case, either; a cumulative study of Supreme Court tax jurisprudence suggests that some of the decisions using nonliteral, purposive interpretations arose as a response to social and economic issues.[178] For instance, a general study of the Supreme Court's tax decisions before and after the Depression era and New Deal suggests that the Court was influenced by the economic and social climate to adopt a stronger

---

169 *Id.* at 592.

170 *Id.* at 595–96 ("Racially discriminatory educational institutions cannot be viewed as conferring a public benefit within the 'charitable' concept discussed earlier, or within the congressional intent underlying . . . § 501(c)(3).").

171 *See* Livingston, *supra* note 137, at 700.

172 *See id.*

173 *See id.*

174 *See Bob Jones Univ.*, 461 U.S. at 595–96.

175 *See id.* at 612–13 (Rehnquist, J., dissenting).

176 *See id.* at 622.

177 *See* Eskridge, *supra* note 138, at 1548.

178 *See* Cummings, *supra* note 128, at 104–05.

progovernment attitude towards tax collection.[179] Prior to the Depression era, the Court maintained protaxpayer tendencies when issuing tax decisions.[180] During the Depression era and the subsequent New Deal era, when there was a greater demand for revenue collection and greater acceptance of a stronger federal tax enforcement regime, the Court's tendencies reversed and it began issuing many more progovernment tax decisions.[181] The broadening of the definition of income and "applying anti-taxpayer presumptions as to deductions" can be attributed to the context of this time period.[182]

Coincidentally, this time period also marked the beginning of prevailing tax avoidance, which forced the Court to further develop progovernmental doctrine to protect the government from abusers of the system.[183] Much of the doctrine that is well known among tax lawyers, such as the substance over form doctrine,[184] assignment of income doctrine,[185] and strict construction of deductions, credits, and exceptions,[186] originated in the 1930s and developed throughout the 1980s, when wealthy taxpayers began forming tax shelters to avoid tax liability.[187] Considering that these doctrines arose in response to a particular brand of tax avoidance that has since then plagued the federal income tax system, one must question whether the principles guiding these doctrines should be universally applied.

IV. Proposal

In consideration of the aforementioned analysis, the Supreme Court should give greater significance to the purpose of section 280E rather than limiting its analysis to a strict reading of the statutory text. Upon doing so, the Supreme Court should reach a decision that excludes individuals operating state-sanctioned medical marijuana dispensaries from the scope of section 280E's prohibition, thus permitting them to deduct their ordinary and necessary business expenses like any other legitimate business owner.

---

179 *See id.* at 81–86.

180 *See id.* at 104–06.

181 *See id.* at 105–06

182 *Id.*

183 *See id.* at 81–82.

184 *See id.* at 87 (citing Gregory v. Helvering, 293 U.S. 465 (1935)).

185 *See id.* at 110–11 (referencing Lucas v. Earl, 281 U.S. 111 (1930), as the "seminal assignment of income opinion").

186 *See id.* at 40.

187 *See id.* at 168–69.

A. *The Supreme Court Should Give Greater Significance to the Purpose of Section 280E Despite the Section's Clear Language*

The above discussion shows that the Supreme Court has occasionally issued decisions that are guided by statutory purpose despite seemingly contrary and clear language in the statutory text. Looking at the above examples of purposive interpretation, each case involved a scenario in which the Justices felt that perhaps the language of the relevant Code section did not adequately accomplish the purpose that Congress intended for the statute to have. In the *Tufts* and *Hillsboro National Bank* cases, the Court issued decisions that essentially protected the government from literal applications of the Code that would have yielded an underreporting of taxable income.[188] Although the statutory language relevant to each of these cases had been written quite clearly, extrinsic indicia such as tax logic and legislative history suggested that the purpose of the statute exceeded that which could be achieved by following the statutory text.[189] With regards to section 280E, a literal application of the statutory language arguably does not respect the purpose that Congress sought to achieve when it enacted the law in 1982.

The primary reason supporting a more in-depth purposive analysis of section 280E is that the nature of the provision in the general context of the tax code is quite exceptional with respect to the general treatment of illegal business expenses.[190] Most individuals that operate illegal businesses are nonetheless allowed to take deductions for ordinary and necessary business expenses, except those that are explicitly prohibited by section 162. This is because, historically, the Court did not distinguish between legal and illegal income in regards to the permissibility of deductions unless it was clear that allowance of a deduction would frustrate well-established public policy and would severely mitigate the effectiveness of a statute intended to punish the taxpayer. The Court disallowed deductions only in rare circumstances when it found it necessary to reinforce other penal statutes that served to harm the taxpayer monetarily. Though not classified as a penalty, these prohibitions amplified the punitive nature of the laws they supported.[191]

---

188 *See supra* notes 140–61.

189 *See supra* Part III.A.

190 *See supra* Part I.A.

191 *See* Borek, *supra* note 40, at 55.

When Congress passed the Tax Reform Act of 1969, it signaled to the Supreme Court that it would assume the responsibility of imposing public policy prohibitions on business expense deductions.[192] Congress then proceeded to enact specific exceptions to the general rule on deductions for illegal business expenses.[193] By creating a prohibition against deductions for only a few taxpayers engaged in illegal activity, Congress effectively imposed greater monetary sanctions for those particular criminal acts, modifying the degree of punishment.[194]

Because section 280E has a quasi-penal nature in that it comes from a lineage of legal decisions designed to specifically reinforce punishment,[195] it would seem that the purpose of section 280E is to hinder drug operations by punishing the taxpayers that derive income from those operations. If section 280E indeed does have a purpose comparable to that of a penalty, the Court should be careful to avoid over broadening the scope of the statute.[196]

In response to this suggestion, opponents would surely argue that the Court has generally refrained from applying purposive statutory interpretation in such a way as to benefit the taxpayer.[197] Rather, they would argue that the Court has selectively implemented this method of construction in order to protect Congress from its own statutory language, particularly in cases where a literal application of the statutory language would allow taxpayers to get unintended benefits at the expense of the government.[198] However, this should not absolutely preclude the Court from making such interpretations of the law in different situations where it would seem to be appropriate; just because the Court has adopted progovernment tendencies should not

---

192 *See id.* at 55–56.

193 *See supra* Part I.A.

194 *See supra* Part I.A.

195 *See supra* notes 43–51 and accompanying text.

196 *See* CUMMINGS, *supra* note 128, at 36–37 ("Penalties traditionally have been applied under a 'rule of lenity' that is applied to the interpretation of criminal statutes. . . . '[P]enal laws are to be construed strictly . . . .'" (footnote omitted) (quoting United States v. Wiltberger, 18 U.S. (5 Wheat.) 76, 95 (1820)); *cf.* Dowling v. United States, 473 U.S. 207, 213 (1985) ("[W]hen assessing the reach of a federal criminal statute, we must pay close heed to language, legislative history, and purpose in order strictly to determine the scope of the conduct the enactment forbids.").

197 *See* CUMMINGS, *supra* note 128, at 8 (noting that the "scope of . . . [judge-made] doctrines generally [has] been uncertain, except in one sense: they always favor the government").

198 *See, e.g.*, Gregory v. Helvering, 293 U.S. 465, 469–70 (1935) (establishing a business purpose requirement to supplement a nonrecognition statute on reorganizations to prevent the taxpayer from avoiding tax liability, even though the taxpayer formally complied with the text of the statute).

necessarily limit purposive interpretations to situations where the Supreme Court is protecting the government.[199]

The perpetual struggle to prevent tax avoidance during a time when the government needed revenue provided a context that naturally justified the Court's creation of progovernment tax doctrine through purposive interpretation of the Code.[200] Indeed, before the 1930s, the courts actually tended to issue opinions with a protaxpayer slant;[201] the fundamental shift occurred only once it became apparent that it was in the public's best interest to protect the government from abusive taxpayers and to ensure that the government's revenue was collected equitably.[202]

The Supreme Court's tendencies to engage in purposive interpretation of Code sections to reach a favorable outcome for the government may thus be explained in part by the general context in which those decisions arose.[203] The progovernment bias permeating through tax doctrine that had developed through purposive statutory interpretation is simply a product of the Court providing equity to the government and responding to the needs of nation, whether that meant preventing certain taxpayers from abusing the tax system or promoting a new, widely-accepted social policy, as was the case in *Bob Jones University*.[204]

It is true the Court does not generally interpret the Code through a purposive lens so as to provide equity for the taxpayer the way that it does to protect the government from the abusive taxpayer.[205] For the most part, this makes sense. Equity is generally reserved to protect persons from penalties and forfeitures, or otherwise to protect the rights of individuals from unfair punishment.[206] Taxes are not treated as penalties, because the collection of revenue is a necessary element

---

199 *See* Zelenak, *supra* note 133, at 669; Peter A. Lowy & Juan F. Vasquez, Jr., *Interpreting Tax Statutes: When Are Statutory Presumptions Justified?*, 4 HOUS. BUS. & TAX L.J. 389, 401–02 (2004) (raising issue with the presumption to construe deductions narrowly). This Note does not attempt to derive a general rule that the Supreme Court may apply when deciding the degree of significance to which to attribute statutory purpose and legislative history. This Note does, however, suggest that even without a generalized rule, each instance can be evaluated in its own context to determine whether the Supreme Court should analyze a statute beyond its text.

200 *See* CUMMINGS, *supra* note 128, at 104; *supra* Part III.B.

201 *See* CUMMINGS, *supra* note 128, at 38 ("As late as 1936 it was thought that the courts applied substance over form in favor of taxpayers 'with absolute impartiality.'").

202 *See id.* at 81–82.

203 *See id.* at 6 (identifying importance of "historical roots of various doctrines" when analyzing court decisions on tax law).

204 *See supra* Part III.B.

205 *See* CUMMINGS, *supra* note 128, at 179.

206 *See id.*

of a functioning government, and Congress has the power to lay taxes as it sees appropriate.[207] Thus, a taxpayer's argument—that he or she should not be taxed for equitable reasons—is generally not given much consideration by courts because the purpose of taxes is not to punish the taxpayer, but rather to impose a civic duty.[208]

However, the purpose itself of section 280E in fact does suggest that it was intended to punish illegal drug dealers.[209] The legislative history of section 280E provides that there is a strong policy against drug dealing.[210] Specifically, because drug dealers drain the government and taxpaying citizens of billions of dollars each year, they should not get the benefit of ordinary and necessary business expense deductions provided by section 162 of the Code.[211] Although deductions for business expenses are understood to be "a matter of grace,"[212] section 280E acts to specifically prohibit a particular group of individuals from taking deductions that would be available to them but for the criminal nature of the business activity in which the taxpayer is engaged.[213] Because of the exceptional nature of section 280E, the Supreme Court can and should analyze the statute's purpose in deciding its applicability to medical marijuana dispensary owners.

B. By Adopting a Purposive Interpretation of Section 280E, the Supreme Court Should Find that Medical Marijuana Dispensaries Should Not Be Prohibited From Deducting Ordinary and Necessary Business Expenses

Upon adopting a purposive interpretation approach, the Supreme Court will then be faced with the challenge of determining whether section 280E was intended to prohibit owners of medical marijuana dispensaries from deducting business expenses from their taxable income. In particular, the altered distinction between drug dealers and medical marijuana dispensary operators between the time of section 280E's enactment versus today and the legislative history accompany-

---

207 *See id.* at 36.

208 *See id.*

209 *See supra* Part I.B.

210 S. REP. NO. 97-494, at 309 (1982), *reprinted in* 1982 U.S.C.C.A.N. 781, 1050.

211 *See id.*

212 Comm'r v. Tellier, 383 U.S. 687, 693 (1966). *But see* Lowy & Vasquez, *supra* note 199, at 402–04 (questioning whether deductions should be understood as a "matter of legislative grace").

213 *See* S. REP. NO. 97-494, at 309, *reprinted in* 1982 U.S.C.C.A.N. at 1050.

ing section 280E tend to support a finding that section 280E was not meant to capture such individuals that operate state-sanctioned medical marijuana businesses.

The purpose of section 280E is revealed, in limited capacity,[214] by the changing social contexts between the time of section 280E's enactment and present day. As mentioned above, because the first state to decriminalize marijuana for medical use did so more than a decade after the enactment of section 280E,[215] the term "drug trafficking" in the statutory language must have meant selling illegal drugs generally. Consequently, the purpose of section 280E must have been to debilitate black-market drug trafficking operations by imposing a greater tax burden on the individuals running those operations.[216]

Determining whether the purpose of section 280E was also intended to hinder legitimate businesses acting lawfully under state law but nonetheless illegally under federal law is much more difficult. Opponents would likely argue that the language of the statute suggests that the prohibition was intended to cover all drug trafficking that is barred under the Controlled Substances Act, regardless of its legality under any state law.[217] Through a purposive lens, however, the Court would also have to consider whether prohibiting medical marijuana dispensaries from taking business deductions aligns with the purpose of the statute.

The context preceding section 280E is quite telling as to which individuals the Code section is meant to penalize. Congress enacted section 280E immediately following the Tax Court decision in *Edmondson* to prohibit ordinary drug dealers from using their status as business operators as a way of justifying deductions for their operating expenses.[218] The Senate Report confirms that Congress did not want to allow these individuals to take business-related deductions because "[t]here is a sharply defined public policy against drug dealing."[219] When section 280E was enacted, Congress's use of the words "drug

---

214 *See* Eskridge, *supra* note 138, at 1480. This Note does not attempt to delve into the rationale supporting or refuting the use of societal, political, or legal changes as part of statutory interpretation analysis. Professor Eskridge's piece provides further insight into this subject, evaluating traditional interpretations alongside his own approach and that of others. *See generally id.*

215 *See supra* Part II.A.

216 *See* S. REP. No. 97-494, at 309, *reprinted in* 1982 U.S.C.C.A.N. at 1050.

217 *See* Californians Helping to Alleviate Medical Problems, Inc. v. Comm'r (*CHAMP*), 128 T.C. 173, 181 (2007).

218 *See* S. REP. No. 97-494, at 309, *reprinted in* 1982 U.S.C.C.A.N. at 1050.

219 *Id.*

dealing" surely could not be understood to contemplate any other type of drug dealing activity beyond that of which the taxpayer in *Edmondson* was guilty. No states had enacted legislation decriminalizing medical marijuana operations at the time,[220] so it would be incorrect to assert that Congress clearly intended to punish businesses operating lawfully under state law but otherwise illegally under the Controlled Substances Act.

Moreover, one of the few stated reasons for not allowing these businesses to deduct operating expenses from gross income is that it would be improper "[t]o 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."[221] This statement is startling because of the sheer magnitude of losses claimed, but it is not quite clear which billions of dollars to which the Senate Committee was referring. Enforcement against drug dealing surely comprised a part of this claimed loss, with funding for this coming from taxpayer money. The DOJ, the entity in charge of prosecuting drug offenders, had an approximately $4.6 billion dollar budget in 1982.[222] In 1980, the budget for the federal DEA, the principal drug enforcement agency within the DOJ, was just over $206 million, which increased to about $362 million by 1985.[223] In 1982, the Federal Bureau of Investigation ("FBI") also gained the jurisdiction to go after narcotics offenders, which significantly increased the amount of resources allocated towards drug enforcement.[224] And these numbers only account for the amount of *federal* dollars that were spent towards drug enforcement. Yet today, the DOJ, and by extension the DEA, is prohibited from spending any of its budget towards enforcement of federal drug laws against state-sanctioned medical marijuana dispensaries, and the states are allowing such operations to persist.[225]

The federal government's stance on medical marijuana dispensaries has conceivably been the same at least throughout the first decade of the 21st century, when federal enforcement of state-sanctioned

---

220 *See supra* Part II.A.

221 S. REP. NO. 97-494, at 309, *reprinted in* 1982 U.S.C.C.A.N. at 1050.

222 *See 1982 United States Budget*, INSIDEGOV, http://federal-budget.insidegov.com/l/85/1982 (last visited Jan. 12, 2016).

223 DRUG ENF'T ADMIN., DEA HISTORY IN DEPTH: 1980–1985, at 44, http://www.dea.gov/about/history/1980-1985.pdf (last visited Jan. 12, 2016).

224 *A Brief History of the FBI*, FED. BUREAU INVESTIGATION, http://www.fbi.gov/about-us/history/brief-history (last visited Jan. 12, 2016).

225 STAFF OF H. RULES COMM., 113TH CONG., TEXT OF H. AMENDMENT TO THE S. AMENDMENT TO H.R. 83, at 213–14 (Comm. Print 2014).

medical marijuana programs curtailed state efforts to regulate the drug as a lawful means of treatment for serious medical conditions.[226] However, in the last seven years, both the DOJ and Congress have issued statements that suggest medical marijuana dispensaries are not to be an enforcement priority, as long as they are operating lawfully under state regulatory programs.[227] If the federal government's current perception of medical marijuana dispensaries is aptly reflected through their current enforcement policies, the scope of taxpayers intended to be encompassed under section 280E would no longer include medical marijuana dispensaries.

Lastly, if the purpose of enacting section 280E was indeed to prevent frustration of a well-defined public policy against drug dealing, it seems counterintuitive that Congress would have intended to hinder such businesses, which can no longer be prosecuted by federally funded agencies, while allowing other, discrete illegal businesses to enjoy the benefits of deducting business expenses.[228] Medical marijuana dispensary operators lie in the unusual position of conducting themselves openly despite the fact that their conduct is illegal under federal law. If prohibitions against deductions are truly to be limited, as the Senate Report suggested when Congress first codified such a prohibition,[229] there appears to be a fundamental flaw in prohibiting medical marijuana dispensaries from taking ordinary and necessary business expense deductions as is allowed for almost every other legal and illegal business outfit.

Conclusion

In the last six years, the federal government has advanced multiple enforcement policies that recognize the distinctions between those businesses that operate legally under state law from other illegitimate drug dealing businesses on the black market.[230] Even though the language of section 280E plainly states that deductions will be disallowed for businesses that traffic controlled substances that are prohibited under federal law,[231] the nature of section 280E suggests that the statute should be interpreted narrowly.[232] As such, the Court should choose to determine what Congress strictly meant by businesses "traf-

226 *See* O'Keefe, *supra* note 78, 49–50.

227 *See supra* Part II.B.

228 *See* Roche, *supra* note 16, at 433–34.

229 *See* S. Rep. No. 91-552, at 273 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2311.

230 *See supra* Part II.B.

231 I.R.C. § 280E (2012).

232 *See supra* Part IV.A.

ficking in controlled substances"[233] by consulting the aforementioned legislative history, context, and purpose upon which the statute was based, rather than simply consulting a dictionary definition.[234] By focusing on the purpose and legislative history of section 280E, it should become clear that its scope should not encompass medical marijuana dispensaries, and that the Supreme Court has reason to find in favor of such business owners.

---

233 I.R.C. § 280E.

234 *See* Californians Helping to Alleviate Medical Problems, Inc. v. Comm'r (*CHAMP*), 128 T.C. 173, 182 (2007).