***Californians Helping to Alleviate Med. Problems, Inc. v. Commissioner, 128 T. C. 173 (U. S. Tax Ct. 2007)***

The U. S. Tax Court ruled that a nonprofit corporation providing medical marijuana and caregiving services could not deduct expenses related to its medical marijuana business under Section 280E, but could deduct expenses for its separate caregiving services. The decision clarifies that businesses involved in illegal drug trafficking cannot deduct related expenses, yet may deduct costs associated with legal, separate business activities. This ruling has significant implications for organizations operating under state medical marijuana laws but facing federal restrictions.

**Parties**

Californians Helping to Alleviate Medical Problems, Inc. (Petitioner) was the plaintiff, challenging the determination of the Commissioner of Internal Revenue (Respondent) in the U. S. Tax Court.

**Facts**

Californians Helping to Alleviate Medical Problems, Inc. (CHAMP) was a California nonprofit public benefit corporation organized to provide caregiving services and medical marijuana to its members suffering from debilitating diseases. CHAMP's members, who primarily had AIDS, cancer, multiple sclerosis, and other serious illnesses, paid a membership fee to access both caregiving services and medical marijuana. The caregiving services included support group sessions, daily lunches, hygiene supplies, counseling, masseuse services, social events, field trips, yoga, online computer access, and political activity encouragement. CHAMP operated from a main facility in San Francisco, where it also distributed medical marijuana, and a church where no marijuana was allowed. CHAMP's financials for the year in question showed gross receipts of $1,056,833, with a reported taxable loss of $239 after deductions.

**Procedural History**

The Commissioner of Internal Revenue issued a notice of deficiency to CHAMP, disallowing all deductions and costs of goods sold as being connected to the illegal sale of drugs under Section 280E of the Internal Revenue Code. CHAMP petitioned the U. S. Tax Court, contesting the disallowance of deductions. The Commissioner conceded the accuracy-related penalty and the disallowance of costs of goods sold, but maintained the disallowance of deductions. The Tax Court was tasked with determining whether Section 280E precluded CHAMP from deducting expenses related to both its medical marijuana and caregiving services.

**Issue(s)**

Whether Section 280E of the Internal Revenue Code precludes CHAMP from

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deducting expenses attributable to its provision of medical marijuana?

Whether Section 280E precludes CHAMP from deducting expenses attributable to its provision of caregiving services?

**Rule(s) of Law**

Section 280E of the Internal Revenue Code states: “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. “

**Holding**

The U. S. Tax Court held that Section 280E precludes CHAMP from deducting expenses attributable to its provision of medical marijuana because such activities constitute “trafficking” in a controlled substance. However, the court further held that CHAMP’s provision of caregiving services and its provision of medical marijuana were separate trades or businesses; thus, Section 280E does not preclude CHAMP from deducting the expenses attributable to the caregiving services.

**Reasoning**

The court analyzed the text of Section 280E and its legislative history, which expressed Congress’s intent to disallow deductions for expenses related to illegal drug trafficking but did not intend to deny all business expenses of a taxpayer simply because they were involved in such trafficking. The court determined that CHAMP’s provision of medical marijuana was “trafficking” as it involved regular buying and selling, even though it was pursuant to California’s Compassionate Use Act. However, the court found that CHAMP’s caregiving services were a separate trade or business, not merely incidental to its marijuana activities. This determination was based on the extensive nature of the caregiving services and the lack of economic interrelationship between the two activities. The court also relied on the credible testimony of CHAMP’s executive director, who stated that the primary purpose of CHAMP was to provide caregiving services. The court apportioned CHAMP’s expenses between the two trades or businesses based on the number of employees and the portion of facilities devoted to each business, allowing deductions for the caregiving services.

**Disposition**

The U. S. Tax Court allowed deductions apportioned to CHAMP’s caregiving services based on the number of employees and space involved in those services, while denying deductions for expenses related to the sale of medical marijuana. The court

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entered its decision under Rule 155 of the Tax Court Rules of Practice and Procedure.

**Significance/Impact**

This case is significant for clarifying the application of Section 280E to businesses involved in state-legal medical marijuana but facing federal restrictions. It establishes that such businesses can still deduct expenses related to separate, legal business activities. The ruling has had a doctrinal impact on how courts interpret and apply Section 280E, affecting the tax treatment of organizations operating under state medical marijuana laws. Subsequent cases have referenced this decision in analyzing the deductibility of expenses in similar contexts. Practically, it underscores the importance of segregating and documenting expenses for different business activities within organizations that engage in both legal and illegal (under federal law) operations.

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