

# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION PART ONE

**Project Name:** Medical Marijuana Establishments - IRC Section 280E

**Date:** 05/11/2010

**Operating Division / Area / Industry/Compliance Center:** California - Area 7 **Initiating Function:** Examination

**Project Completion Date:** 12/30/2011 **MACS Identified Workload?** ☐ Yes ☒ No

**NAICS Code:** ? **Project Code:** 0539 **Uniform Issue Code:** IRC 280E **ERCS Tracking Code (if applicable):** 0529

**Contact Person:** Elain Li (925) 974-3750  
(Coordinator) (Name) (Phone Number)

**Form Type:**

**Which one of your Operating Division's "Strategies" does this CIP support? (See instructions)**

**If none, please justify**

## REVIEW and CONCURRENCE: (See instructions for each Operating Division)

|  |   |                           |
|--|---|---------------------------|
| <u>Disclosure Manager</u><br>Title           | <u>Daniel Lopez</u><br>Signature<br><small>Digitally signed by Daniel Lopez<br/>DN: cn=Daniel Lopez, o=IRS<br/>Date: 2010.05.14 10:44:57 -0700</small>                | <u>06/04/2010</u><br>Date |
| <u>PSP Territory Manager</u><br>Title        | <u>DeGina LaCour</u><br>Signature<br><small>Digitally signed by DeGina LaCour<br/>DN: cn=DeGina LaCour, o=IRS<br/>Date: 2010.07.08 10:44:57 -0700</small>             | <u>07/08/2010</u><br>Date |
| <u>PSP Section Chief, Section 1</u><br>Title | <u>Gloria A. Heredia</u><br>Signature<br><small>Digitally signed by Gloria A. Heredia<br/>DN: cn=Gloria A. Heredia, o=IRS<br/>Date: 2010.07.22 09:36:18 -0700</small> | <u></u><br>Date           |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date           |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date           |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date           |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date           |

**Approval:** (See instructions for each Operating Division and forward a copy to each respective Operating Division's CIP Program Analyst)

|                  |                      |                 |
|------------------|----------------------|-----------------|
| <u></u><br>Title | <u></u><br>Signature | <u></u><br>Date |
|------------------|----------------------|-----------------|

## PART ONE- EXTENSION

**PROJECT EXTENSION\*:** 06/30/2012  
Extension Date

**APPROVALS** (See instructions for each Operating Division)

**EXTENSION 6 MONTHS OR LESS:**  
(Information copy to HQ CIP Program Analyst)

|                                       |  |                           |
|---------------------------------------|--|---------------------------|
| <u>PSP Territory Manager</u><br>Title | <u>Susan Braunz</u><br>Signature<br><small>Digitally signed by Susan Braunz<br/>DN: cn=Susan Braunz, o=IRS<br/>Date: 2010.12.15 10:44:57 -0700</small> | <u>12/15/2011</u><br>Date |
|---------------------------------------|--|---------------------------|

**EXTENSION EXCEEDING 6 MONTHS:**

|                  |                      |                 |
|------------------|----------------------|-----------------|
| <u></u><br>Title | <u></u><br>Signature | <u></u><br>Date |
|------------------|----------------------|-----------------|

\* (Attach explanation why extension is required.)



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - Instructions

For your Operating Division's "Strategies" refer to the respective web site links below:

SB/SE Strategies - <http://sbse.web.irs.gov/srpm/>

LMSB Strategies - <http://lmsb.irs.gov/initiatives/initiatives.htm>

W&I Strategies - <http://win.web.irs.gov/strategy.htm>

*Insert the titles and corresponding names for your division on the title line and under the signature line. The person then **must sign and date** the form.*

### For Review and Concurrence section.

If **SB/SE - Compliance:** Territory Manager

Disclosure Officer

TEC Territory Manager

Other Affected Functions

If **SB/SE - TEC:**

TEC Territory Manager

Disclosure Officer

Other Affected Functions

PSP Area Support Manager

If the CIP originates in a headquarters function (other than PSP), it will be reviewed by the Functional Director.

If **LMSB:** Team Manager

Territory Manager

Applicable Director of Field Operation

Disclosure Officer

If the CIP originates in a headquarters office, the procedures for Part Two will be followed.

If **W&I:** Campus Operations Manager

Headquarters Analyst

### For Approval section.

If **SB/SE - Compliance:** PSP Area Support Manager or Field

Compliance Services Operations Manager

If **SB/SE - TEC:** TEC Area Director

If the CIP originates in a headquarters function, it will be approved by the Director, Reporting Compliance or delegate..

If **LMSB:** Operations Support Manager, Strategy

Research & Program Planning

If **W&I:** Chief, Strategy and Selection or delegate

### For Extension Approvals section.

If **SB/SE:**

#### **6 months or less**

**Compliance:** PSP Area Support Manager or Field  
Compliance Services Operations Manager  
(Forward a copy to Headquarters CIP  
Program Analyst)

**TEC:** TEC Area Director

If **LMSB:**

Director of Field Operations

Operations Support Manager, Strategy Research & Program Planning

If **W&I:**

Chief, Strategy and Selection or delegate

#### **More than 6 months**

**Compliance:** PSP Area Support Manager or Field  
Compliance Services Operations Manager  
Headquarters CIP Program Analyst  
Director, Compliance Workload Selection  
& Delivery

**TEC:**

Director, Pre-filing Compliance

Director, Compliance Workload Selection &  
Delivery



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - NARRATIVE

Project Name Medical Marijuana Establishments - IRC Section 280E

**A. BACKGROUND and OBJECTIVES:** Provide information that will be useful for a better understanding of the proposed project. State issues, how identified, and impact on compliance. Describe sources used to determine duplicate or similar projects, either open or closed, and results. Does this project fit into one of your division's operating strategies? State project objective(s) and expected results.

The last few years there has been a large number of "Medical Marijuana" shops open in California and on the Internet. This is due to the California Compassionate Use Act of 1996, codified at Cal. Health & Safety Code Sec. 11362.5. According to (State of California) Board of Equalization analysis in support of SB 1098 (01/14/08), the National Organization for the Reform of Marijuana (Cal Normal) estimates there are over 400 medical cannabis dispensaries in California. To identify the scale of the industry, of the over 400 dispensaries, twenty-one (21) had permits and reported Gross sales of \$47.6 million dollars.

In 128 T.C. 173 Californians Helping to Alleviate Medical Problems, Inc. v. C.I.R. (2007), the Tax Court upheld IRC Sec. 280E disallowing all expenses with the exception of Cost of Goods Sold.

The objective is compliance. From prior and current cannabis exams, substantiation of all expenses, specifically substantiation for CGS, has been the main issue. The cannabis clubs do not keep records for CGS due to fear of compromising the identity of their suppliers in the event of a raid by law enforcement. In addition, the cannabis clubs would only be allowed a deduction for CGS, if substantiated per IRC 6001. All other remaining expenses related to the cannabis business would be disallowed under IRC 280E as expenditures in connection with the illegal sale of drugs as was the case in Californians Helping to Alleviate Medical Problems, Inc. This compliance issue would be consistent regardless of whether or not the cannabis club operated with/without a permit. Further more, according to California Guidelines for Medical Marijuana issued by the California Attorney General, subsection 1.F, the Attorney General states that "California did not "legalize" medical marijuana but instead exercised its power not to punish certain offenses under state law when physician has recommended its use. It should be noted that dispensaries should document members contributions and 'track and record the source of their marijuana.'" p. 10. Additionally, we believe there maybe some medical marijuana businesses under reporting their income or not filing required tax returns at all.

(b)(7)(E)

**B. MARKET SEGMENT:** Define the market segment. If a market segment is not predefined, provide a detailed description of the taxpayer group from which the market segment will be identified.

There is a high likelihood that a good deal of the 400+ "Medical Marijuana" stores are non-filers and/or are not reporting there sales. Additionally, those who do file are probably deducting Other Business Expenses in contravention to IRC Sec 280E and 128 T.C. 173 Californians Helping to Alleviate Medical Problems, Inc. v. C.I.R. (2007).

Additionally, if the seller is not growing the "Medical Marijuana", they must be buying from a grower. There is a good probability that the grower is a non-filer or under-reporting gross sales. If they are reporting the business, it is very likely they are probably deducting Cost of Goods Sold in contravention to IRC Sec 280E and 128 T.C. 173 Californians Helping to Alleviate Medical Problems, Inc. v. C.I.R. (2007). If the distributor is also a grower/farmer, no COGS is allowed. The cultivating activities would need to be reported on Schedule F. All the expenses incurred to grow the cannabis on Schedule F would be other expenses that would be disallowed per IRC 280E.

If successful, this project could go nationwide and help find a good number of under reporters and non-filers were cannabis has been legalized by the state.



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - NARRATIVE (Continuation)

Project Name Medical Marijuana Establishments - IRC Section 280E

**C. DATA:** Identify data needed for the project and the source and an assessment of its accuracy. For external data, include expected delivery date(s), delivery media, amount of time the data will be held, method of storing/maintaining and ultimate destruction/disposition.

(b)(7)(E)

Data for this project were gathered from cases that were audited and cases that are currently under audit.

The following filters should be applied when identifying cases for this project:

(b)(7)(E)

Additionally, further internet research should be conducted to identify those business are related to Medical Marijuana.

**D. TIME FRAMES / ACTION PLAN:** List the tasks necessary to complete the project, estimated time to accomplish each task and the projected task completion dates. Action plan dates should be consistent with the final project completion date.

(b)(7)(E)

1) Research & Development (6 months)

- a) Input parameters in IRS computers using [redacted] to order returns.
- b) Classify/Review returns for [redacted] to identify returns with the most potential for noncompliance.
- c) Build case file [redacted]
- d) [redacted]

(b)(7)(E)

(b)(7)(E)

2) Implementation (9 months)

- a) Identify RA and/or TCO for project
- b) Training (2 hours)
- c) Workload delivery and assignment
- d) Monitor progress
- e) Monitor for adjustments
- f) Measure results

# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION PART ONE

**Project Name:** Medical Marijuana Establishments - IRC Section 280E

**Date:** 05/11/2010

**Operating Division / Area / Industry/Compliance Center:** California - Area 7 **Initiating Function:** Examination

**Project Completion Date:** 12/30/2011 **MACS Identified Workload?** ☐ Yes ☒ No

**NAICS Code:** ? **Project Code:** TBD **Uniform Issue Code:** IRC 280E **ERCS Tracking Code (if applicable):** TBD

**Contact Person:** Elain Li (925) 974-3750  
(Coordinator) (Name) (Phone Number) (b)(7)(E)

**Form Type:**

**Which one of your Operating Division's "Strategies" does this CIP support? (See instructions)**  (b)(7)(E)

*If none, please justify*

## REVIEW and CONCURRENCE: (See instructions for each Operating Division)

|  |   |                           |
|--|---|---------------------------|
| <u>Disclosure Manager</u><br>Title           | <u>Daniel Lopez</u><br>Signature<br><small>Digitally signed by Daniel Lopez<br/>DN: cn=Daniel Lopez, o=IRS<br/>Date: 2010.04.10 10:44:57 -0700</small>                | <u>06/04/2010</u><br>Date |
| <u>PSP Territory Manager</u><br>Title        | <u>DeGina LaCour</u><br>Signature<br><small>Digitally signed by DeGina LaCour<br/>DN: cn=DeGina LaCour, o=IRS<br/>Date: 2010.04.10 10:44:57 -0700</small>             | <u>07/08/2010</u><br>Date |
| <u>PSP Section Chief, Section 1</u><br>Title | <u>Gloria A. Heredia</u><br>Signature<br><small>Digitally signed by Gloria A. Heredia<br/>DN: cn=Gloria A. Heredia, o=IRS<br/>Date: 2010.04.10 10:44:57 -0700</small> | <u></u><br>Date           |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date           |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date           |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date           |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date           |

**Approval:** (See instructions for each Operating Division and forward a copy to each respective Operating Division's CIP Program Analyst)

|                  |                      |                 |
|------------------|----------------------|-----------------|
| <u></u><br>Title | <u></u><br>Signature | <u></u><br>Date |
|------------------|----------------------|-----------------|

## PART ONE- EXTENSION

**PROJECT EXTENSION\*:**   
Extension Date

**APPROVALS** (See instructions for each Operating Division)

**EXTENSION 6 MONTHS OR LESS:**  
(Information copy to HQ CIP Program Analyst)

|                  |                      |                 |
|------------------|----------------------|-----------------|
| <u></u><br>Title | <u></u><br>Signature | <u></u><br>Date |
|------------------|----------------------|-----------------|

**EXTENSION EXCEEDING 6 MONTHS:**

|                  |                      |                 |
|------------------|----------------------|-----------------|
| <u></u><br>Title | <u></u><br>Signature | <u></u><br>Date |
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*Insert the titles and corresponding names for your division on the title line and under the signature line. The person then **must sign and date** the form.*

### For Review and Concurrence section.

|   |   |
|---|---|
| <b>If <u>SB/SE - Compliance</u>:</b> Territory Manager<br>Disclosure Officer<br>TEC Territory Manager<br>Other Affected Functions | <b>If <u>SB/SE - TEC</u>:</b> TEC Territory Manager<br>Disclosure Officer<br>Other Affected Functions<br>PSP Area Support Manager |
|---|---|

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**If LMSB:** Team Manager  
Territory Manager  
Applicable Director of Field Operation  
Disclosure Officer

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Headquarters Analyst

### For Approval section.

|  |   |
|--|---|
| <b>If <u>SB/SE - Compliance</u>:</b> PSP Area Support Manager or Field<br>Compliance Services Operations Manager | <b>If <u>SB/SE - TEC</u>:</b> TEC Area Director |
|--|---|

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|  |   |
|--|---|
| <b>If <u>LMSB</u>:</b> Operations Support Manager, Strategy<br>Research & Program Planning | <b>If <u>W&amp;I</u>:</b> Chief, Strategy and Selection or delegate |
|--|---|

### For Extension Approvals section.

**If SB/SE:**

#### 6 months or less

**Compliance:** PSP Area Support Manager or Field  
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(Forward a copy to Headquarters CIP  
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Project Name Medical Marijuana Establishments - IRC Section 280E

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(b)(7)(E)

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Additionally, if the seller is not growing the "Medical Marijuana", they must be buying from a grower. There is a good probability that the grower is a non-filer or under-reporting gross sales. If they are reporting the business, it is very likely they are probably deducting Cost of Goods Sold in contravention to IRC Sec 280E and 128 T.C. 173 Californians Helping to Alleviate Medical Problems, Inc. v. C.I.R. (2007). If the distributor is also a grower/farmer, no COGS is allowed. The cultivating activities would need to be reported on Schedule F. All the expenses incurred to grow the cannabis on Schedule F would be other expenses that would be disallowed per IRC 280E.

If successful, this project could go nationwide and help find a good number of under reporters and non-filers were cannabis has been legalized by the state.



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - NARRATIVE (Continuation)

Project Name Medical Marijuana Establishments - IRC Section 280E

C. **DATA:** Identify data needed for the project and the source and an assessment of its accuracy. For external data, include expected delivery date(s), delivery media, amount of time the data will be held, method of storing/maintaining and ultimate destruction/disposition.

Data for this project were gathered from cases that were audited and cases that are currently under audit.

The following filters should be applied when identifying cases for this project:

- 1) Using the NAICS codes for Pharmacist/Drugstores 446110, Other Health/Personal Care Store 446190, and Office of All Other Miscellaneous Health Practitioners 621399.
- 2) Cases with Gross profit percentage > 29% and Net profit percentage < 2.5%.

Additionally, further internet research should be conducted to identify those business are related to Medical Marijuana.

Furthermore, the IRS could request names and addresses of taxpayer who applied for Seller's Permits through the local municipalities or Board of Equalization. In 2008 the BOE offered amnesty to sellers if they voluntarily came in for sellers permits. It is possible a good number of the sellers applied for permits with the Board of Equalization. Using this information, PSP should be able to find non-filers or under-reporters.

D. **TIME FRAMES / ACTION PLAN:** List the tasks necessary to complete the project, estimated time to accomplish each task and the projected task completion dates. Action plan dates should be consistent with the final project completion date.

(b)(7)(E)

1) Research & Development (6 months)

- a) Input parameters in IRS computers using [redacted] to order returns.
- b) Classify/Review returns for large [redacted] to identify returns with the most potential for noncompliance.
- c) Build case file
- d) [redacted]

(b)(7)(E)

(b)(7)(E)

2) Implementation (9 months)

- a) Identify RA and/or TCO for project
- b) Training (2 hours)
- c) Workload delivery and assignment
- d) Monitor progress
- e) Monitor for adjustments
- f) Measure results



## Memo

6 months extension requested in order to better evaluate the project results. Additional time needed to better assess the future of the project.

(b)(3)26 U.S.C. §  
6103



**COMPLIANCE INITIATIVE PROJECT AUTHORIZATION**  
**PART ONE - NARRATIVE (Continuation)**

**Project Name** Medical Marijuana Establishments - IRC Section 280E

- C. **DATA:** Identify data needed for the project and the source and an assessment of its accuracy. For external data, include expected delivery date(s), delivery media, amount of time the data will be held, method of storing/maintaining and ultimate destruction/disposition.

Data for this project were gathered from cases that were audited and cases that are currently under audit.

(b)(7)(E)

The following filters should be applied when identifying cases for this project:

Additional internet research will be conducted to identify those businesses as cannabis clubs/medical marijuana dispensaries.

All Personally Identifiable Information (PII) data is secured by the CDE Program and by any function or examiner that will be utilizing the specific return information during an audit. Data will be properly disposed of at the end of the project.

- D. **ALTERNATIVE TREATMENTS:** Consideration should be given to identify various ways to improve voluntary compliance other than audits which are generally the most expensive and intrusive way to increase compliance. Examples are: taxpayer outreach/education, revision of forms or publications, legislative or regulatory changes, agreements with state or local business licensing authorities for tax compliance requirements.

Alternative treatments will be considered based on the results of the Part II project.



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - NARRATIVE (Continuation)

Project Name Medical Marijuana Establishments - IRC Section 280E

E. **MEASURES AND ANALYSIS:** Describe measures to evaluate noncompliance for purposes of monitoring and follow-up compliance activities.

The measurement of the project will be from the audit results on ACIS and the testimony of the compliance staff that works the cases.

F. **COST / BENEFIT:** Describe resources needed to conduct the project in terms of hours expended by type of examiner and additional costs over and above what would normally be expended.

The cost of running the filters on CDE is minimal and the time required is also minimal as this filter is already established. The benefits expected are lower time on case, lower cycle times, lower no-change rates, and comparable dollars per hour when compared to DIF.

G. **TIME FRAMES / ACTION PLAN:** List the tasks necessary to complete the project, estimated time to accomplish each task and the projected task completion dates. Action plan dates should be consistent with the final project completion date.

Part II CIP approval process expected to be completed in August 2012  
Returns identified, established, and case built - about 5 weeks (ongoing)  
Cases sent to the field as part of the monthly return orders (ongoing)  
Project may be extended



## **PC0539 Medical Marijuana Part II Extension 06302015**

Requesting an 18 month extension for PC0539 Part II CIP. With the SBSE realignment, the Southwest Area (Area 07) added the states of Hawaii, Arizona, and New Mexico. Both Arizona and New Mexico allow for the use of marijuana for medicinal purposes (as verified by <http://www.azdhs.gov/medicalmarijuana/> and <http://nmhealth.org/mcp/>). Hawaii; however, does not allow for the use of marijuana in any form.

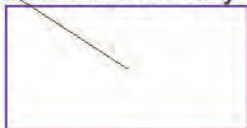
Marijuana is still a federally banned substance, and so the current CIP would be applicable to Arizona and New Mexico as both states have medical marijuana dispensaries. An 18 month extension is requested because time is needed in order to filter, case build, audit, and monitor the results for cases designated for Arizona and New Mexico.

Based on 173 cases closed in the prior 36 months (A-CIS ending 11/22/2013):

- |                               |     |                      |
|-------------------------------|-----|----------------------|
| • \$1,375 dollars per hour    | vs. | \$493 RA DIF FY13    |
| • 24.5 average hours          | vs. | 34.9 hrs RA DIF FY13 |
| • 4.6% no-change rate         | vs. | 23.5% RA DIF FY13    |
| • 65.9% pick-up rate          | vs. | 42.4% RA DIF FY13    |
| • 281 days average cycle time | vs. | 257 days RA DIF FY13 |

Every metric above is significantly better (with the exception of the cycle time which is only comparable to) than RA DIF FY13 results. Additional breakdown can be provided upon request.

Potential inventory is as follows:



(b)(7)(E)

**COMPLIANCE INITIATIVE PROJECT AUTHORIZATION**  
**PART ONE - NARRATIVE (Continuation)**

**Project Name** Medical Marijuana Establishments - IRC Section 280E

**C. DATA:** Identify data needed for the project and the source and an assessment of its accuracy. For external data, include expected delivery date(s), delivery media, amount of time the data will be held, method of storing/maintaining and ultimate destruction/disposition.

(b)(7)(E)

Data for this project were gathered from cases that were audited and cases that are currently under audit.

The following filters should be applied when identifying cases for this project:

Additional internet research will be conducted to identify those businesses as cannabis clubs/medical marijuana dispensaries.

All Personally Identifiable Information (PII) data is secured by the CDE Program and by any function or examiner that will be utilizing the specific return information during an audit. Data will be properly disposed of at the end of the project.

**D. ALTERNATIVE TREATMENTS:** Consideration should be given to identify various ways to improve voluntary compliance other than audits which are generally the most expensive and intrusive way to increase compliance. Examples are: taxpayer outreach/education, revision of forms or publications, legislative or regulatory changes, agreements with state or local business licensing authorities for tax compliance requirements.

Alternative treatments will be considered based on the results of the Part II project.



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**COMPLIANCE INITIATIVE PROJECT AUTHORIZATION**  
**PART ONE - NARRATIVE (Continuation)**

**Project Name** Medical Marijuana Establishments - IRC Section 280E

**E. MEASURES AND ANALYSIS:** Describe measures to evaluate noncompliance for purposes of monitoring and follow-up compliance activities.

The measurement of the project will be from the audit results on ACIS and the testimony of the compliance staff that works the cases.

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## **PC0539 Medical Marijuana Part II Extension 06302015**

Requesting an 18 month extension for PC0539 Part II CIP. With the SBSE realignment, the Southwest Area (Area 07) added the states of Hawaii, Arizona, and New Mexico. Both Arizona and New Mexico allow for the use of marijuana for medicinal purposes (as verified by <http://www.azdhs.gov/medicalmarijuana/> and <http://nmhealth.org/mcp/>). Hawaii; however, does not allow for the use of marijuana in any form.

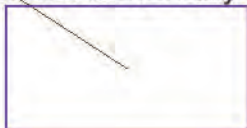
Marijuana is still a federally banned substance, and so the current CIP would be applicable to Arizona and New Mexico as both states have medical marijuana dispensaries. An 18 month extension is requested because time is needed in order to filter, case build, audit, and monitor the results for cases designated for Arizona and New Mexico.

Based on 173 cases closed in the prior 36 months (A-CIS ending 11/22/2013):

- |                               |     |                      |
|-------------------------------|-----|----------------------|
| • \$1,375 dollars per hour    | vs. | \$493 RA DIF FY13    |
| • 24.5 average hours          | vs. | 34.9 hrs RA DIF FY13 |
| • 4.6% no-change rate         | vs. | 23.5% RA DIF FY13    |
| • 65.9% pick-up rate          | vs. | 42.4% RA DIF FY13    |
| • 281 days average cycle time | vs. | 257 days RA DIF FY13 |

Every metric above is significantly better (with the exception of the cycle time which is only comparable to) than RA DIF FY13 results. Additional breakdown can be provided upon request.

Potential inventory is as follows:





## **PC0539 Medical Marijuana Part II Extension 06302015**

Requesting an 18 month extension for PC0539 Part II CIP. With the SBSE realignment, the Southwest Area (Area 07) added the states of Hawaii, Arizona, and New Mexico. Both Arizona and New Mexico allow for the use of marijuana for medicinal purposes (as verified by <http://www.azdhs.gov/medicalmarijuana/> and <http://nmhealth.org/mcp/>). Hawaii; however, does not allow for the use of marijuana in any form.

Marijuana is still a federally banned substance, and so the current CIP would be applicable to Arizona and New Mexico as both states have medical marijuana dispensaries. An 18 month extension is requested because time is needed in order to filter, case build, audit, and monitor the results for cases designated for Arizona and New Mexico.

Based on 173 cases closed in the prior 36 months (A-CIS ending 11/22/2013):

- \$1,375 dollars per hour
- 24.5 average hours
- 4.6% no-change rate
- 65.9% pick-up rate
- 281 days average cycle time

Every metric above is better than or comparable to RA DIF results. Additional breakdown can be provided upon request.

# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART TWO

Project Name: Medical Marijuana Establishments - IRC Section 280E

Date: 7/25/2012

Operating Division / Area / Industry/Compliance Center: SBSE CA Area 7 Project Completion Date: 12/31/2013 Initiating Function: CA Area 7 - PSP

Termination Report Due Date: 9/30/2014 MACS Identified Workload? ☒ Yes ☐ No

NAICS Code: NA Project Code: 0539 Uniform Issue Code: NA ERCS Tracking Code (if applicable): various

Contact Person: Abbott Wang 949-389-4242  
(Coordinator) (Name) (Phone Number)

Form Type: (b)(7)(E)

Which one of your Operating Division's "Strategies" does this CIP support? (See instructions)  
Enforcing the tax law to ensure everyone meets their obligations to pay taxes

If none, please justify \_\_\_\_\_

### REVIEW and CONCURRENCE: (See instructions for each Operating Division)

|  |   |                              |
|--|---|------------------------------|
| <u>PSP Section Chief</u><br>Title            | <u>Brad Puskas</u><br>Brad Puskas, PSP Manager Section #5<br>Signature<br><small>Digitally signed by Brad Puskas<br/>DN: cn=Brad Puskas<br/>Date: 2012.07.26 17:24:14 -0700</small> | <u>July 26, 2012</u><br>Date |
| <u>Acting PSP Territory Manager</u><br>Title | <u>Susan Braunz</u><br>Signature<br><small>Digitally signed by Susan Braunz<br/>DN: cn=Susan Braunz, email=susan.braunz@irs.gov<br/>Date: 2012.07.26 17:24:14 -0700</small>         | <u>July 27, 2012</u><br>Date |
| <u>Director, California Exam</u><br>Title    | <u>1XKFB</u><br>Signature<br><small>Digitally signed by 1XKFB<br/>DN: cn=1XKFB, email=Ann.O.Underland@irs.gov<br/>Date: 2012.08.21 08:10:52 -0400</small>                           | <u>July 27, 2012</u><br>Date |
| <u>HQ CIP Analyst</u><br>Title               | <u>Ann O. Underland</u><br>Signature<br><small>Digitally signed by Ann O. Underland<br/>DN: cn=V7YCB, email=Joan.E.Thell@irs.gov<br/>Date: 2012.08.20 10:11:47 -0400</small>        | <u>8-20-2012</u><br>Date     |
| <u>acting Prog. Mgr. ERS</u><br>Title        | <u>V7YCB</u><br>Signature<br><small>Digitally signed by Marie A Twarog<br/>DN: cn=Marie A Twarog, c=US<br/>Date: 2012.08.27 08:42:56 -0400</small>                                  | <u>8/27/2012</u><br>Date     |
| <u>HQ Disclosure</u><br>Title                | <u>Marie A Twarog</u><br>Signature  |                              |
| <u>_____</u><br>Title                        | <u>Marie Twarog</u><br>Signature  |                              |
| <u>_____</u><br>Title                        | <u>_____</u><br>Signature   |                              |
| <u>_____</u><br>Title                        | <u>_____</u><br>Signature   |                              |
| <u>_____</u><br>Title                        | <u>_____</u><br>Signature   |                              |

### Approval: (See instructions for each Operating Division and forward a copy to each respective Operating Division's CIP Program Analyst)

|                               |   |                      |
|-------------------------------|---|----------------------|
| <u>Director, EPD</u><br>Title | <u>Karen M. Schiller</u><br>Karen M. Schiller<br>Signature<br><small>DN: cn=H89FB, email=Karen.M.Schiller@irs.gov<br/>Date: 2012.08.20 10:11:47 -0400</small> | <u>_____</u><br>Date |
| <u>_____</u><br>Title         | <u>_____</u><br>Signature   | <u>_____</u><br>Date |





# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART TWO - Instructions

For your Operating Division's "Strategy" refer to your respective web site links below:

SB/SE Strategies - <http://sbse.web.irs.gov/srpm/>

LMSB Strategies - <http://lmsb.irs.gov/initiatives/initiatives.htm>

W&I Strategies - <http://win.web.irs.gov/strategy.htm>

Insert the titles and corresponding names for your division on the title line and under the signature line. The person then **must sign and date** the form.

### Under Review and Concurrence section.

#### If SB/SE - Compliance:

Territory Manager  
Managers/Directors of Other Affected Functions  
CLD Chief, Operations Support  
Disclosure Officer  
Area Director  
PSP Area Support Manager  
Headquarters Program Manager  
(example: non-filer, Exam Specialization Program,  
IRA Penalties, etc.)  
Headquarters CIP Program Analyst  
Headquarters Manager, Examination Return Selection

#### If SB/SE - Campus:

Program Manager, Workload Selection and Delivery  
Disclosure Officer  
CIP Headquarter Analyst

#### If SB/SE - CLD:

CLD Stakeholder Liaison  
Disclosure Officer  
Managers/Directors of Other Affected Functions  
PSP Area Support Manager  
CLD Area Director

If CIP originates in a headquarters function (other than EPD), it will be reviewed for concurrence by the Functional Director. Final Approval will be the Director, of Exam Planning & Delivery.

#### If LMSB:

Territory Manager/Headquarters Manager  
Director of Field Operations/Director of International Compliance Strategy & Policy  
Disclosure Officer  
Designated CIP Headquarter/Industry Analyst or  
the PSP for Foreign Residence Compliance  
LMSB CIP Analyst

#### If W&I:

Campus Compliance Operations Manager  
Disclosure Officer  
Headquarters Analyst  
Chief, Strategy and Selection or delegate

### For Approval section.

#### If SB/SE Compliance:

Director, Exam Planning & Delivery

#### If SB/SE Campus Compliance:

Director of Campus Reporting Compliance  
Director, Exam Planning & Delivery

#### If LMSB:

Operations Planning & Support Senior Manager,  
Planning, Quality, Analysis & Support

#### If SB/SE - CLD:

Director of Planning, Quality, Analysis & Support

#### If W&I:

Director, Reporting Compliance.

**Note:** For LMSB, the CIP must be presented to the CIP Oversight Committee.

### For Extension Approvals section.

#### If SB/SE:

##### 6 months or less

##### Compliance:

PSP Area Support Manager  
(Forward a copy to Headquarters CIP Program Analyst)

##### Campus:

Program Manager Workload Selection and Delivery  
Workload Planning & Analysis Program Manager

##### CLD:

CLD Area Director

##### 6 months or more

##### Compliance:

PSP Area Support Manager  
Director, of Exam Planning & Delivery

##### Campus:

Field Director, Compliance Services or delegate  
Service Center Exam Program Manager  
Workload Planning & Analysis Program Manager  
Headquarters CIP Program Analyst  
Director, of Campus Reporting Compliance  
Director, of Exam Planning & Delivery

##### CLD:

CLD Area Director  
Director, of Exam Planning & Delivery

#### If LMSB:

Operations Planning & Support Senior Manager,  
Planning, Quality, Analysis & Support  
Director of Planning, Quality, Analysis & Support

#### If W&I:

Chief, Strategy and Selection or delegate

**Note:** For LMSB, the CIP must be presented to the CIP Oversight Committee.



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART TWO - NARRATIVE

Project Name Medical Marijuana Establishments - IRC Section 280E

A. **BACKGROUND and OBJECTIVES:** Provide information that will be useful for a better understanding of the proposed project including results of Part One, if applicable. State issues, how identified, and impact on compliance. Describe sources used to determine duplicate or similar projects, either open or closed, and results. Does this project fit into one of your division's operating strategies? State project objective(s) and expected results.

The last few years there has been a large number of "Medical Marijuana" shops open in California and on the Internet. This is due to the California Compassionate Use Act of 1996, codified at Cal. Health & Safety Code Sec. 11362.5. According to (State of California) Board of Equalization analysis in support of SB 1098 (01/14/08), the National Organization for the Reform of Marijuana (Cal Normal) estimates there are over 400 medical cannabis dispensaries in California. To identify the scale of the industry, of the over 400 dispensaries, twenty-one (21) had permits and reported Gross sales of \$47.6 million dollars.

In 128 T.C. 173 Californians Helping to Alleviate Medical Problems, Inc. v. C.I.R. (2007), the Tax Court upheld IRC Sec. 280E disallowing all expenses with the exception of Cost of Goods Sold.

The objective is compliance. From prior and current cannabis exams, substantiation of all expenses, specifically substantiation for CGS, has been the main issue. The cannabis clubs do not keep records for CGS due to fear of compromising the identity of their suppliers in the event of a raid by law enforcement. In addition, the cannabis clubs would only be allowed a deduction for CGS if substantiated per IRC Sec. 6001. All other remaining expenses related to the cannabis business would be disallowed under IRC 280E as expenditures in connection with the illegal sale of drugs as was the case in Californians Helping to Alleviate Medical Problems, Inc. This compliance issue would be consistent regardless of whether or not the cannabis club operated with/without a permit. Further more, according to California Guidelines for Medical Marijuana issued by the California Attorney General, subsection 1.F., the Attorney General states that "California did not 'legalize' medical marijuana but instead exercised its power not to punish certain offenses under state law when physician has recommended its use. It should be noted that dispensaries should document members contributions and 'track and record the source of their marijuana.'" p. 10. Additionally, we believe there maybe some medical marijuana businesses under reporting their income or not filing required tax returns at all. (b)(7)(E)

As of June 29, 2012, RAs have closed 91 cases from the Part I CIP. The 91 cases (b)(7)(E) have yielded an average time per case of 22.5 hours with a 3.3% no-change rate. When compared to DIF results of 32.4 hours per case and a 20.2% no-change rate, the cases are being closed quicker along with a much lower no-change rate than DIF returns. In addition, the 91 cases have an average cycle time of 204 days which is lower than DIF of 260 days. The 91 cases have also yielded an average \$945/hour with a 62.6% pick-up rate which are both significantly higher than DIF results of \$544/hour and 46.7% pick-up rate. (Data based on ACIS period ending 6/29/2012)

Note: Western Area had conducted a CIP part 1 on Medical Marijuana, the fallout from that CIP was only for (b)(7)(E)

B. **MARKET SEGMENT:** Define the market segment. If a market segment is not predefined, provide a detailed description of the taxpayer group from which the market segment will be identified.

(b)(7)(E) High Income Taxpayers (TGR > \$300,000) in Area 7 (California SBSE) including C-Corps, S-Corps, Partnerships, Sch-C (Self-Employed), Non-Fileers and Taxpayer not reporting the sales of "Medical Marijuana".

Additionally, if the seller is not growing the "Medical Marijuana", they must be buying from a grower. There is a good probability that the grower is a non-filer or under-reporting gross sales. If they are reporting the business, it is very likely they are probably deducting Cost of Goods Sold in contravention to IRC Sec. 280E and 128 T.C. 173. Californians Helping to Alleviate Medical Problems, Inc. v. C.I.R. (2007). If the distributor is also a grower/farmer, no COGS is allowed. The cultivating activities would need to be reported on Schedule F. All the expenses incurred to grow the cannabis on Schedule F would be other expenses that would be disallowed per IRC 280E.



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART TWO

Project Name: Medical Marijuana Establishments - IRC Section 280E

Date: 7/25/2012

Operating Division / Area / Industry/Compliance Center: SBSE CA Area 7 Project Completion Date: 12/31/2013 Initiating Function: CA Area 7 - PSP

Termination Report Due Date: 9/30/2014 MACS Identified Workload? ☒ Yes ☐ No

(b)(7)(E) NAICS Code: NA Project Code: 0539 Uniform Issue Code: NA ERCS Tracking Code (if applicable): TBD

Contact Person: Abbott Wang 949-389-4242  
(Coordinator) (Name) (Phone Number)

Form Type:

Which one of your Operating Division's "Strategies" does this CIP support? (See instructions)

Enforcing the tax law to ensure everyone meets their obligations to pay taxes

If none, please justify

### REVIEW and CONCURRENCE: (See instructions for each Operating Division)

|  |   |                              |
|--|---|------------------------------|
| <u>PSP Section Chief</u><br>Title            | <u>Brad Puskas</u><br>Digitally signed by Brad Puskas<br>DN: cn=Brad Puskas<br>Date: 2012.07.25 17:24:14 -0700<br><u>Brad Puskas, PSP Manager Section #5</u><br>Signature   | <u>July 26, 2012</u><br>Date |
| <u>Acting PSP Territory Manager</u><br>Title | <u>Susan Braunz</u><br>Digitally signed by Susan Braunz<br>DN: cn=Susan Braunz, email=susan.braunz@irs.gov<br>Date: 2012.07.27 10:10:00<br><u>Susan Braunz</u><br>Signature | <u>July 27, 2012</u><br>Date |
| <u>Director, California Exam</u><br>Title    | <u>1XKFB</u><br>Digitally signed by 1XKFB<br>DN: cn=1XKFB, email=Ann.O.Underland@irs.gov<br>Date: 2012.08.21 08:16:52 -0400<br><u>Ann O. Underland</u><br>Signature         | <u>July 27, 2012</u><br>Date |
| <u>HQ CIP Analyst</u><br>Title               | <u>V7YCB</u><br>Digitally signed by V7YCB<br>DN: cn=V7YCB, email=Joan.L.Frull@irs.gov<br>Date: 2012.08.20 10:31:47 -0400<br><u>DeGina LaCour</u><br>Signature               | <u>8-20-2012</u><br>Date     |
| <u>acting Prog. Mgr. ERS</u><br>Title        | <u>Marie A Twarog</u><br>Digitally signed by Marie A Twarog<br>DN: cn=Marie A Twarog, c=US<br>Date: 2012.08.27 08:42:56 -0400<br><u>Marie A Twarog</u><br>Signature         | <u>8/27/2012</u><br>Date     |
| <u>HQ Disclosure</u><br>Title                | <u>Marie Twarog</u><br>Signature  | <u></u><br>Date              |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date              |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date              |
| <u></u><br>Title                             | <u></u><br>Signature  | <u></u><br>Date              |

### Approval: (See instructions for each Operating Division and forward a copy to each respective Operating Division's CIP Program Analyst)

|                               |  |                 |
|-------------------------------|--|-----------------|
| <u>Director, EPD</u><br>Title | <u>Karen M. Schiller</u><br>DN: cn=NBXFE, email=Karen.M.Schiller@irs.gov<br>Date: 2012.08.20 21:12:43 -0400<br><u>Karen M. Schiller</u><br>Signature | <u></u><br>Date |
| <u></u><br>Title              | <u></u><br>Signature   | <u></u><br>Date |



## COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART TWO

Project Name: Medical Marijuana Establishments - IRC Section 280E

CROSS-DIVISIONAL CIP:

Title

Signature

Date \_\_\_\_\_

Title

Signature

Date \_\_\_\_\_

## PART TWO - EXTENSION

## EXTENSION OF TIME:

### 1st Extension

Extension Date

Title

Signature \_\_\_\_\_

Date \_\_\_\_\_

**Concurrence:**

Title

**Signature**

Date \_\_\_\_\_

## 2nd Extension

Extension Date

Title

Signature \_\_\_\_\_

Date \_\_\_\_\_

Concurrence:

Title

Signature

Date \_\_\_\_\_

### 3rd Extension

Extension Date

Title

Signature \_\_\_\_\_

Date \_\_\_\_\_

Concurrence:

Title

Signature

Date \_\_\_\_\_

# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART TWO - Instructions

For your Operating Division's "Strategy" refer to your respective web site links below:

SB/SE Strategies - <http://sbse.web.irs.gov/srpm/>

LMSB Strategies - <http://lmsb.irs.gov/initiatives/initiatives.htm>

W&I Strategies - <http://win.web.irs.gov/strategy.htm>

Insert the titles and corresponding names for your division on the title line and under the signature line. The person then **must** sign and date the form.

### Under Review and Concurrence section.

#### If SB/SE - Compliance:

Territory Manager  
Managers/Directors of Other Affected Functions  
CLD Chief, Operations Support  
Disclosure Officer  
Area Director  
PSP Area Support Manager  
Headquarters Program Manager  
(example: non-filer, Exam Specialization Program,  
IRA Penalties, etc.)  
Headquarters CIP Program Analyst  
Headquarters Manager, Examination Return Selection

#### If SB/SE - Campus:

Program Manager, Workload Selection and Delivery  
Disclosure Officer  
CIP Headquarter Analyst

#### If SB/SE - CLD:

CLD Stakeholder Liaison  
Disclosure Officer  
Managers/Directors of Other Affected Functions  
PSP Area Support Manager  
CLD Area Director

If CIP originates in a headquarters function (other than EPD), it will be reviewed for concurrence by the Functional Director. Final Approval will be the Director, of Exam Planning & Delivery.

#### If LMSB:

Territory Manager/Headquarters Manager  
Director of Field Operations/Director of International Compliance Strategy & Policy  
Disclosure Officer  
Designated CIP Headquarter/Industry Analyst or  
the PSP for Foreign Residence Compliance  
LMSB CIP Analyst

#### If W&I:

Campus Compliance Operations Manager  
Disclosure Officer  
Headquarters Analyst  
Chief, Strategy and Selection or delegate

### For Approval section.

#### If SB/SE Compliance:

Director, Exam Planning & Delivery

#### If SB/SE Campus Compliance:

Director of Campus Reporting Compliance  
Director, Exam Planning & Delivery

#### If LMSB:

Operations Planning & Support Senior Manager,  
Planning, Quality, Analysis & Support

#### If SB/SE - CLD:

Director of Planning, Quality, Analysis & Support

#### If W&I:

Director, Reporting Compliance.

**Note:** For LMSB, the CIP must be presented to the CIP Oversight Committee.

### For Extension Approvals section.

#### If SB/SE:

##### 6 months or less

##### Compliance:

PSP Area Support Manager  
(Forward a copy to Headquarters CIP Program Analyst)

##### Campus:

Program Manager Workload Selection and Delivery  
Workload Planning & Analysis Program Manager

##### CLD:

CLD Area Director

##### 6 months or more

##### Compliance:

PSP Area Support Manager  
Director, of Exam Planning & Delivery

##### Campus:

Field Director, Compliance Services or delegate  
Service Center Exam Program Manager  
Workload Planning & Analysis Program Manager  
Headquarters CIP Program Analyst  
Director, of Campus Reporting Compliance  
Director, of Exam Planning & Delivery

##### CLD:

CLD Area Director  
Director, of Exam Planning & Delivery

#### If LMSB:

Operations Planning & Support Senior Manager,  
Planning, Quality, Analysis & Support  
Director of Planning, Quality, Analysis & Support

#### If W&I:

Chief, Strategy and Selection or delegate

**Note:** For LMSB, the CIP must be presented to the CIP Oversight Committee.



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART TWO - NARRATIVE

Project Name Medical Marijuana Establishments - IRC Section 280E

A. **BACKGROUND and OBJECTIVES:** Provide information that will be useful for a better understanding of the proposed project including results of Part One, if applicable. State issues, how identified, and impact on compliance. Describe sources used to determine duplicate or similar projects, either open or closed, and results. Does this project fit into one of your division's operating strategies? State project objective(s) and expected results.

The last few years there has been a large number of "Medical Marijuana" shops open in California and on the Internet. This is due to the California Compassionate Use Act of 1996, codified at Cal. Health & Safety Code Sec. 11362.5. According to (State of California) Board of Equalization analysis in support of SB 1098 (01/14/08), the National Organization for the Reform of Marijuana (Cal Normal) estimates there are over 400 medical cannabis dispensaries in California. To identify the scale of the industry, of the over 400 dispensaries, twenty-one (21) had permits and reported Gross sales of \$47.6 million dollars.

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The objective is compliance. From prior and current cannabis exams, substantiation of all expenses, specifically substantiation for CGS, has been the main issue. The cannabis clubs do not keep records for CGS due to fear of compromising the identity of their suppliers in the event of a raid by law enforcement. In addition, the cannabis clubs would only be allowed a deduction for CGS if substantiated per IRC Sec. 6001. All other remaining expenses related to the cannabis business would be disallowed under IRC 280E as expenditures in connection with the illegal sale of drugs as was the case in Californians Helping to Alleviate Medical Problems, Inc. This compliance issue would be consistent regardless of whether or not the cannabis club operated with/without a permit. Further more, according to California Guidelines for Medical Marijuana issued by the California Attorney General, subsection 1.F., the Attorney General states that "California did not 'legalize' medical marijuana but instead exercised its power not to punish certain offenses under state law when physician has recommended its use. It should be noted that dispensaries should document members contributions and 'track and record the source of their marijuana.'" p. 10. Additionally, we believe there maybe some medical marijuana businesses under reporting their income or not filing required tax returns at all.

As of June 29, 2012, RAs have closed 91 cases from the Part I CIP. The 91 cases [redacted] have yielded an average time per case of 22.5 hours with a 3.3% no-change rate. When compared to DIF results of 32.4 hours per case and a 20.2% no-change rate, the cases are being closed quicker along with a much lower no-change rate than DIF returns. In addition, the 91 cases have an average cycle time of 204 days which is lower than DIF of 260 days. The 91 cases have also yielded an average \$945/hour with a 62.6% pick-up rate which are both significantly higher than DIF results of \$544/hour and 46.7% pick-up rate. (Data based on ACIS period ending 6/29/2012)

(b)(7)(E)

B. **MARKET SEGMENT:** Define the market segment. If a market segment is not predefined, provide a detailed description of the taxpayer group from which the market segment will be identified.

(b)(7)(E)

There is a high likelihood that a good deal of the 400+ "Medical Marijuana" stores are non-filers and/or are not reporting there sales. Additionally, those who do file are probably deducting Other Business Expenses in contravention to IRC Sec 280E and 128 T.C. 173 Californians Helping to Alleviate Medical Problems, Inc. v. C.I.R. (2007).

Additionally, if the seller is not growing the "Medical Marijuana", they must be buying from a grower. There is a good probability that the grower is a non-filer or under-reporting gross sales. If they are reporting the business, it is very likely they are probably deducting Cost of Goods Sold in contravention to IRC Sec. 280E and 128 T.C. 173 Californians Helping to Alleviate Medical Problems, Inc. v. C.I.R. (2007). If the distributor is also a grower/farmer, no COGS is allowed. The cultivating activities would need to be reported on Schedule F. All the expenses incurred to grow the cannabis on Schedule F would be other expenses that would be disallowed per IRC 280E.



# Compliance Initiative Project Termination Report

Function/Division

Small Business Self-Employed / Compliance Initiative Projects / Planning and Special Programs

|  |  |                                       |
|--|--|---------------------------------------|
| <b>Area/Industry</b>                       | <b>Requesting Function</b>                                     |                                       |
| Southwest Area 207                         | Planning and Special Programs - Compliance Initiative Projects |                                       |
| <b>Project Name</b>                        | <b>Project Number (optional)</b>                               | <b>Termination Date</b>               |
| Medical Marijuana Establishments (b)(7)(E) | 0539 (Tracking Code 0502)                                      | June 30, 2015 (b)(3) 26 U.S.C. § 6103 |

| Project Results (A)                         |              |              |           |                         |              |
|---|--------------|--------------|-----------|-------------------------|--------------|
| Number of returns examined                  | 30           | 128          | (b)(7)(E) |                         | 13           |
| Number of returns no-changed                | 4            | 4            | None      |                         | None         |
| Number of returns surveyed                  | None         | None         | None      |                         | None         |
| Average time per return                     | 20.8 Hours   | 37.9 Hours   |           | (b)(3) 26 U.S.C. § 6103 | 4.4 Hours    |
| Avg. deficiency or adjustment (1120S, 1065) | \$675 / Hour | \$2,788/Hour |           |                         | \$756 / Hour |

|  |          |          |          |  |          |
|--|----------|----------|----------|--|----------|
| Other results:   |          |          |          |  |          |
| 1. No-Change Rate  | 13.3%    | 3.1%     | 0.0 %    |  | 0.0 %    |
| 2. Pick-Up Rate  | 100.0%   | 42.2%    | 100.0%   |  | 100.0%   |
| 3. Cycle Time  | 293 Days | 379 Days | 165 Days |  | 185 Days |
| (b)(7)(E) Number of referrals to Criminal Investigation      | None     | None     | None     |  | None     |
| (b)(7)(E) Number of joint investigations from such referrals | None     | None     | None     |  | None     |

Was noncompliance addressed? Explain. (b)(7)(E)

Yes. This project was extended to Part II. Part I and Part II (b)(7)(E) examinations resulted in \$2,788 per hour, which is above the SBSE (b)(7)(E) DIF average of \$686 per hour. Furthermore, the project's (b)(7)(E) no-change rate of 3.1% is better than SBSE (b)(7)(E) DIF average of 28.5%. The (b)(7)(E) received valuable education regarding non-deductible medical (b)(7)(E) marijuana expenses. All returns, except seventy-four of the (b)(7)(E) returns, were related pick-ups.

Did the results of the project justify the time and resources spent? Explain. (b)(7)(E)

Yes. Minimal time and resources were spent on this project as the workload was identified by CDE filters. Based upon Part I (b)(7)(E) results, this project was extended to Part II. (b)(7)(E) received valuable education regarding the deductibility of medical marijuana expenses. (b)(7)(E) examinations for this project averaged 37.9 hours per return, which is less than the SBSE (b)(7)(E) DIF average of 49.9 hours per return.

What difficulties were encountered and how were they resolved? (b)(7)(E)

No difficulties were noted by examiners. However, only 44 of the 128 (b)(7)(E) returns (34.4%) closed agreed via Disposal Codes 03 and 04. 52 of the 128 (b)(7)(E) returns (40.6%) were issued Statutory Notices of Deficiencies that defaulted.

Describe successful procedures and/or audit techniques used.

In addition to normal audit techniques, examiners were provided with Californians Helping to Alleviate Medical Problems, Inc. v. C.I.R. U.S. Tax Court 2007 decision and a Summary of the application(s) of IRC §280E as defined by the above court decision.

|   |   |  |
|---|---|--|
| <b>Project Coordinator: (Printed Name)</b>        | <b>Signature:</b> Hannah Lee<br>2016.03.07 12:02:33 -08'00'   | <b>Telephone Number:</b><br>(213) 576-3991 |
| Hannah Lee  | <b>Title:</b><br>PSP Section Chief  | <b>Date:</b>                               |
| <b>Project Approving Official: (Printed Name)</b> | <b>Signature:</b>   | <b>Telephone Number:</b><br>(213) 576-3669 |
| Chris Simmons                                     | <b>Title:</b><br>PSP Territory Manager  | <b>Date:</b><br>03/16/2016                 |
| <b>Project Approving Official: (Printed Name)</b> | <b>Signature:</b> Chris Simmons<br><small>Digitally signed by Kori A. McEwen<br/>DN: cn=Kori A. McEwen, o=Internal Revenue Service, ou=Internal Revenue Service, email=kori.mcewen@irs.gov</small>      | <b>Telephone Number:</b>                   |
| Kori McEwen                                       | <b>Title:</b> Senior Program Analyst<br><small>Digitally signed by Kori A. McEwen<br/>DN: cn=Kori A. McEwen, o=Internal Revenue Service, ou=Internal Revenue Service, email=kori.mcewen@irs.gov</small> | <b>Date:</b><br>3/21/2016                  |



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## Instructions for Termination Report

Compliance Initiative Projects should be terminated prior to the authorized completion date when any of the following conditions have been met:

- Noncompliance has been addressed
- Results don't justify time spent
- Resources are no longer available
- Other circumstances indicate that the project is no longer viable

A termination report must be submitted when substantially all cases have closed but no later than 6 months after the project completion date including extensions.

### Project Approving Official

For **SB/SE Compliance**: Area Director/Director of Exam Planning and Delivery if headquarters CIP  
PSP Area Support Manager

For **SB/SE Campus**: Field Director, Compliance Services or Delegate  
Director of Reporting Compliance

For **SB/SE CLD**: CLD Area Director  
PSP Area Support Manager

For all SB/SE Project Terminations, a copy of the termination report should be sent to the Headquarters CIP Program Analyst.

For **LMSB**: Industry/Headquarter Director  
Operations Support Manager, Strategy Research and Program Planning

For **W&I**: Chief, Discretionary Examination

# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE

Project Name: Medical Marijuana

Date: 06/15/2011 Project Completion Date: 12/31/2012

Operating Division / Area / Industry/Compliance Center: SBSE Western Area Exam Initiating Function: PSP

Termination Report Due Date: 09/15/2013 CDE Identified Workload? ☒ Yes ☐ No

NAICS Code: (b)(7)(E) Project Code: 0178 Uniform Issue Code: (b)(7)(E) ERCS Tracking Code (if applicable): (b)(7)(E)

Contact Person: Sharon P Ryan 303-603-4810  
(Coordinator) (Name) (Phone Number)

Form Type: (b)(7)(E)

Which one of your Operating Division's "Strategies" does this CIP support? (See instructions)

Increase compliance among SBSE Taxpayers including Under reporting and Non-filers - (b)(7)(E)

If none, please justify (b)(7)(E)

### REVIEW and CONCURRENCE: (See instructions for each Operating Division)

|                            |                  |           |
|----------------------------|------------------|-----------|
| PSP Section Chief          | Robert D. Brewer | 6/14/2011 |
| Title                      | Signature        | Date      |
| Acting, Disclosure Manager | SLJFB            | 7/12/2011 |
| Title                      | Signature        | Date      |
| HQ CIP Analyst             | Christie Lyons   | 7/14/2011 |
| Title                      | Signature        | Date      |
|                            | Signature        | Date      |
|                            | Signature        | Date      |
|                            | Signature        | Date      |
|                            | Signature        | Date      |

### Approval: (See instructions for each Operating Division and forward a copy to each respective Operating Division's CIP Program Analyst)

|                       |            |            |
|-----------------------|------------|------------|
| PSP Territory Manager | Ken Cooper | 06/15/2011 |
| Title                 | Signature  | Date       |

## PART ONE - EXTENSION

PROJECT EXTENSION\*: (b)(7)(E)  
Extension Date

### APPROVALS (See instructions for each Operating Division)

EXTENSION 6 MONTHS OR LESS:  
(Information copy to HQ CIP Program Analyst)

|       |           |      |
|-------|-----------|------|
| Title | Signature | Date |
| Title | Signature | Date |

EXTENSION EXCEEDING 6 MONTHS:

|       |           |      |
|-------|-----------|------|
| Title | Signature | Date |
| Title | Signature | Date |

\* (Attach explanation why extension is required.)



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - Instructions

For your Operating Division's "Strategies" refer to the respective web site links below:

SB/SE Strategies - <http://sbse.web.irs.gov/srpm/>

LMSB Strategies - <http://lmsb.irs.gov/initiatives/initiatives.htm>

W&I Strategies - <http://win.web.irs.gov/strategy.htm>

Insert the titles and corresponding names for your division on the title line and under the signature line. The person then **must sign and date** the form.

### Under Review and Concurrence section

#### If **SB/SE - Compliance:**

CLD Stakeholder Liaison  
Disclosure Officer  
Other Affected Functions

#### If **SB/SE - Campus:**

Program Manager Workload Selection & Delivery  
Disclosure Officer  
CIP Headquarter Analyst

#### If **SB/SE - CLD:**

CLD Stakeholder Liaison  
Disclosure Officer  
Other Affected Functions  
PSP Territory Manager

If CIP originates in a headquarters function (other than EPD), it will be reviewed for concurrence by the Functional Director. Final Approval will be the Director, of Exam Planning & Delivery.

#### If **LMSB:**

Team Manager  
Territory Manager  
Applicable Director of Field Operation  
Disclosure Officer  
Designated CIP Headquarter/Industry Analyst or the PSP for Foreign  
Residence Compliance  
LMSB CIP Analyst

#### If **W&I:**

Disclosure Officer  
Headquarters Analyst

If the CIP originates in a headquarter office (including Field Specialists) then the CIP must be presented to the CIP Oversight Committee.

### For Approval Section

#### If **SB/SE - Compliance:**

PSP Territory Manager

#### If **SB/SE - Campus:**

Director, Reporting Compliance  
Exam Planning & Delivery

#### If **SB/SE - CLD:**

CLD Area Director

If the CIP originates in a headquarters function, it will be approved by the Director, Reporting Compliance or delegate.

#### If **LMSB:**

Operations Planning & Support Manager; Planning, Quality, Analysis & Support

#### If **W&I:**

Chief, Strategy and Selection or delegate

### For Extension Approvals section

#### If **SB/SE:**

##### 6 months or less

##### Compliance:

PSP Territory Manager

##### Campus:

Program Manager Workload Selection and Delivery  
Workload Planning & Analysis Program Manager

##### CLD:

CLD Area Director

##### 6 months or more

##### Compliance:

PSP Territory Manager  
Director, of Exam Planning & Delivery

##### Campus:

Field Director, Compliance Services or delegate  
Service Center Exam Program Manager  
Workload Planning & Analysis Program Manager  
Headquarters CIP Program Analyst  
Director, of Campus Reporting Compliance  
Director, of Exam Planning & Delivery

##### CLD:

CLD Area Director  
Director, of Exam Planning & Delivery

#### If **LMSB:**

Director of Field Operations/Director of International Compliance Strategy & Policy  
Operations Planning & Support Manager; Planning, Quality, Analysis & Support

#### If **W&I:**

Chief, Strategy and Selection or delegate

Forward a copy of all Extensions to the SB/SE CIP Program Analyst.



**COMPLIANCE INITIATIVE PROJECT AUTHORIZATION**  
**PART ONE - NARRATIVE**

**Project Name** Medical Marijuana

**A. BACKGROUND and OBJECTIVES:** Provide information that will be useful for a better understanding of the proposed project. State issues, how identified, and impact on compliance. Describe sources used to determine duplicate or similar projects, either open or closed, and results. Does this project fit into one of your division's operating strategies? State project objective(s) and expected results.

Under Federal law, Marijuana (Cannabis) is a controlled substance. Currently nine (9) of twelve (12) Western Area states have passed laws related to the use, possession and cultivation of marijuana (cannabis) for medicinal purposes. Businesses related to this industry are flourishing in these states. The licensing/registration requirements vary from state to state. The marijuana market is estimated to be worth \$10 to \$120 billion, the largest cash crop in the country. This is a very cash intensive industry.

**SEC. 280E. EXPENDITURES IN CONNECTION WITH THE ILLEGAL SALE OF DRUGS.**

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.

The objective of the project is to examine returns, [REDACTED] that report income/expenses related to the cultivation/growing, product preparation/infusion, dispensing/selling, and prescribing of medicinal marijuana. The examinations will determine compliance with reporting all gross receipts, including cash, using direct and/or indirect methods. Further, the examinations will determine compliance of reporting under section 280E, which restricts the deduction of expenses.

A search of the National CIP database revealed a similar project in California. However there are not any project results available that would either justify or not justify the pursuit of this project. General industry research/information and state regulating/licensing information was referred for the Western Area.

As a Part One CIP, the project will be limited to fifty (50) taxpayer contacts

**B. MARKET SEGMENT:** Define the market segment. If a market segment is not predefined, provide a detailed description of the taxpayer group from which the market segment will be identified.

The NAICS codes used for reporting purposes vary within the industry and have not yet been identified.

The businesses that have been identified as being related to this industry include:



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - NARRATIVE (Continuation)

**Project Name** Medical Marijuana

(b)(7)(E)

**C. DATA:** Identify data needed for the project and the source and an assessment of its accuracy. For external data, include expected delivery date(s), delivery media, amount of time the data will be held, method of storing/maintaining and ultimate destruction/disposition.

CDE data with appropriate filters will be utilized to identify inventory for this project. IDRS and other internal resources will be used as needed. The identified CDE population will be evaluated for examination potential and classified. PSP staff will be responsible for the requisition of returns.

All CDE filters and requests will be associated with the administrative file and destroyed in accordance with the normal retention schedules. All other internal data secured for this project, such as IDRS, will be retained according to normal retention schedules or destroyed upon completion or termination of the project, whichever comes first. No external data is anticipated for this project.

**D. TIME FRAMES / ACTION PLAN:** List the tasks necessary to complete the project, estimated time to accomplish each task and the projected task completion dates. Action plan dates should be consistent with the final project completion date.

| Responsible Party | Action Plan  | Completion Date |
|-------------------|--|-----------------|
| PSP Staff         | Complete CIP and route for approval  | 06/30/2011      |
| PSP Staff         | External Information/Data Requests   | 08/31/2011      |
| PSP Staff         | CDE research to identify inventory<br>order returns and classify inventory | 10/31/2011      |
| SBSE Compliance   | Examination of Returns   | 12/31/2012      |
| PSP Staff         | Monitoring   | Ongoing         |



# Compliance Initiative Project Termination Report

## Function/Division

SBSE - Western Area PSP - Compliance Field Examination

|   |                                  |                         |  |
|---|----------------------------------|-------------------------|--|
| <b>Area/Industry</b>                      | <b>Requesting Function</b>       |                         |  |
| Western Area PSP                          | Western Area PSP                 |                         |  |
| <b>Project Name</b>                       | <b>Project Number (optional)</b> | <b>Termination Date</b> |  |
| Medical Marijuana (b)(3):26 U.S.C. § 6103 | 0178                             | 9/30/2014 (b)(7)(E)     |  |

| Project Results (A)                                |          |       |      |  |  |                         |
|--|----------|-------|------|--|--|-------------------------|
| Number of returns examined                         | 67       | 16    | 10   |  |  | 9                       |
| Number of returns no-changed                       | 4.1      |       | 0    |  |  | 0                       |
| Number of returns surveyed                         | 8        |       |      |  |  |                         |
| Average time per return                            | 13       | 62.3  | 67.7 |  |  | 1.9                     |
| Avg. deficiency or adjustment (1120S, 1065)        | \$15,781 | \$0   | \$0  |  |  | \$1,814                 |
| Other results:                                     |          |       |      |  |  |                         |
| 1. \$/Hour   | \$1,211  | \$0   | \$0  |  |  | \$961                   |
| 2. % No change                                     | 6.1%     | 6.3%  | 0%   |  |  | 0%                      |
| 3. % Related Pickup                                | 86.7%    | 43.7% | 50%  |  |  | 100%                    |
| Number of referrals to Criminal Investigation      | 4        | 3     |      |  |  | (b)(3):26 U.S.C. § 6103 |
| Number of joint investigations from such referrals |          |       |      |  |  |                         |

Was noncompliance addressed? Explain.

The project focused on the examination of returns, (b)(7)(E) that report income/expenses related to the cultivation/growing, product preparation/infusion, dispensing/selling and prescribing of medicinal marijuana. Section 280E of the Internal Revenue Code states that no expenses will be allowed during a tax year in carrying on any trade or business if the trade consists of trafficking in controlled substances. Noncompliance has been addressed. Most (b)(7)(E) had taken expenses on their (b)(7)(E)

Did the results of the project justify the time and resources spent? Explain.

The project results for (b)(7)(E) returns over the life cycle of the project ended 8/31/2014 include: Average Dollars per Hour of \$1,211. There was a no change rate of only 6.1% for (b)(7)(E) returns, 6.1% for (b)(7)(E) returns and 0% for both (b)(7)(E) and employment taxes. Related pick up percentages were 86.7% for (b)(7)(E) returns. The cycle time of the audits was 296. With the exception of the cycle time, the results are all better than DIF results. The cycle time on the (b)(7)(E)

What difficulties were encountered and how were they resolved?

Examiners did not report encountering any difficulties on this project.

Describe successful procedures and/or audit techniques used.

Feedback reports received from examiners did not identify any successful procedures or audit techniques.

|   |  |                                       |
|---|--|---------------------------------------|
| <b>Project Coordinator: (Printed Name)</b>        | <b>Signature:</b> F3RDB                | <b>Telephone Number:</b> 303-603-4836 |
| Susan K Wilson                                    | <b>Title:</b> PSP CIP Coordinator      | <b>Date:</b> 9/29/2014                |
| <b>Project Approving Official: (Printed Name)</b> | <b>Signature:</b> 26GLB                | <b>Telephone Number:</b> 303-603-4736 |
| Christal Laybourne                                | <b>Title:</b> Acting PSP Section Chief | <b>Date:</b> 10/1/2014                |
| <b>Project Approving Official: (Printed Name)</b> | <b>Signature:</b> Tommy D. McDonald    | <b>Telephone Number:</b> 303-603-4703 |
| Lois E Deitrich                                   | <b>Title:</b> PSP Territory Manager    | <b>Date:</b> 10/01/2014               |



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## Instructions for Termination Report

Compliance Initiative Projects should be terminated prior to the authorized completion date when any of the following conditions have been met:

- Noncompliance has been addressed
- Results don't justify time spent
- Resources are no longer available
- Other circumstances indicate that the project is no longer viable

A termination report must be submitted when substantially all cases have closed but no later than 6 months after the project completion date including extensions.

### Project Approving Official

For **SB/SE Compliance**: Area Director/Director of Exam Planning and Delivery if headquarters CIP  
PSP Area Support Manager

For **SB/SE Campus**: Field Director, Compliance Services or Delegate  
Director of Reporting Compliance

For **SB/SE CLD**: CLD Area Director  
PSP Area Support Manager

For all SB/SE Project Terminations, a copy of the termination report should be sent to the Headquarters CIP Program Analyst.

For **LMSB**: Industry/Headquarter Director  
Operations Support Manager, Strategy Research and Program Planning

For **W&I**: Chief, Discretionary Examination

# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE

Project Name: Section 280E Expenses - Marijuana Businesses

Date: 1/4/2016 Project Completion Date: 12/31/2016

Operating Division / Area / Industry/Compliance Center: SBSE Western Area Exam Initiating Function: PSP

Termination Report Due Date: 6/30/2017 MACS Identified Workload? ☐ Yes ☒ No

NAICS Code: \_\_\_\_\_ Project Code: \_\_\_\_\_ Uniform Issue Code: \_\_\_\_\_ ERCS Tracking Code (if applicable): \_\_\_\_\_

Contact Person: Jake Riley (435) 634-5566  
(Coordinator) (Name) (Phone Number)

Form Type: (b)(7)(E) (b)(7)(E)

Which one of your Operating Division's "Strategies" does this CIP support? (See instructions)  
Increase compliance among SBSE taxpayers including under reporting and non-filers -

If none, please justify \_\_\_\_\_

### REVIEW and CONCURRENCE: (See instructions for each Operating Division)

|                       |                          |                 |
|-----------------------|--------------------------|-----------------|
| PSP Territory Manager | <u>Kenneth D. Cooper</u> | <u>2/9/2016</u> |
| Title                 | Signature                | Date            |
| Disclosure Officer    | _____                    | _____           |
| Title                 | Signature                | Date            |
| _____                 | _____                    | _____           |
| Title                 | Signature                | Date            |
| _____                 | _____                    | _____           |
| Title                 | Signature                | Date            |
| _____                 | _____                    | _____           |
| Title                 | Signature                | Date            |
| _____                 | _____                    | _____           |
| Title                 | Signature                | Date            |

### Approval: (See instructions for each Operating Division and forward a copy to each respective Operating Division's CIP Program Analyst)

|                      |                        |                   |
|----------------------|------------------------|-------------------|
| Acting Area Director | <u>Kristin L. Bonn</u> | <u>02/09/2016</u> |
| Title                | Signature              | Date              |

## PART ONE - EXTENSION

PROJECT EXTENSION\*: 06/30/2017  
Extension Date

### APPROVALS (See instructions for each Operating Division)

#### EXTENSION 6 MONTHS OR LESS: (Information copy to HQ CIP Program Analyst)

|                                    |                           |       |
|------------------------------------|---------------------------|-------|
| <u>Area Director, Western Area</u> | <u>Guadalupe N. Ortiz</u> | _____ |
| Title                              | Signature                 | Date  |
| _____                              | _____                     | _____ |
| Title                              | Signature                 | Date  |

#### EXTENSION EXCEEDING 6 MONTHS:

|       |           |       |
|-------|-----------|-------|
| _____ | _____     | _____ |
| Title | Signature | Date  |
| _____ | _____     | _____ |
| Title | Signature | Date  |

\*(Attach explanation why extension is required.)



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - Instructions

For your Operating Division's "Strategies" refer to the respective web site links below:

SB/SE Strategies - <http://sbse.web.irs.gov/srpm/>

LMSB Strategies - <http://lmsb.irs.gov/initiatives/initiatives.htm>

W&I Strategies - <http://win.web.irs.gov/strategy.htm>

Insert the titles and corresponding names for your division on the title line and under the signature line. The person then **must sign and date** the form.

### Under Review and Concurrence section

If **SB/SE - Compliance:**

CLD Stakeholder Liaison  
Disclosure Officer  
Other Affected Functions

If **SB/SE - Campus:**

Program Manager Workload Selection & Delivery  
Disclosure Officer  
CIP Headquarter Analyst

If **SB/SE - CLD:**

CLD Stakeholder Liaison  
Disclosure Officer  
Other Affected Functions  
PSP Territory Manager

If CIP originates in a headquarters function (other than EPD), it will be reviewed for concurrence by the Functional Director. Final Approval will be the Director, of Exam Planning & Delivery.

If **LMSB:**

Team Manager  
Territory Manager  
Applicable Director of Field Operation  
Disclosure Officer  
Designated CIP Headquarter/Industry Analyst or the PSP for Foreign  
Residence Compliance  
LMSB CIP Analyst

If **W&I:**

Disclosure Officer  
Headquarters Analyst

If the CIP originates in a headquarter office (including Field Specialists) then the CIP must be presented to the CIP Oversight Committee.

### For Approval Section

If **SB/SE - Compliance:**

PSP Territory Manager

If **SB/SE - Campus:**

Director, Reporting Compliance  
Exam Planning & Delivery

If **SB/SE - CLD:**

CLD Area Director

If the CIP originates in a headquarters function, it will be approved by the Director, Reporting Compliance or delegate.

If **LMSB:**

Operations Planning & Support Manager; Planning, Quality, Analysis & Support

If **W&I:**

Chief, Strategy and Selection or delegate

### For Extension Approvals section

If **SB/SE:**

**6 months or less**

**Compliance:**

PSP Territory Manager

**Campus:**

Program Manager Workload Selection and Delivery  
Workload Planning & Analysis Program Manager

**CLD:**

CLD Area Director

**6 months or more**

**Compliance:**

PSP Territory Manager  
Director, of Exam Planning & Delivery

**Campus:**

Field Director, Compliance Services or delegate  
Service Center Exam Program Manager  
Workload Planning & Analysis Program Manager  
Headquarters CIP Program Analyst  
Director, of Campus Reporting Compliance  
Director, of Exam Planning & Delivery

**CLD:**

CLD Area Director  
Director, of Exam Planning & Delivery

If **LMSB:**

Director of Field Operations/Director of International Compliance Strategy & Policy  
Operations Planning & Support Manager; Planning, Quality, Analysis & Support

If **W&I:**

Chief, Strategy and Selection or delegate

Forward a copy of all Extensions to the SB/SE CIP Program Analyst.



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - NARRATIVE

Project Name Section 280E Expenses - Marijuana Businesses

- A. **BACKGROUND and OBJECTIVES:** Provide information that will be useful for a better understanding of the proposed project. State issues, how identified, and impact on compliance. Describe sources used to determine duplicate or similar projects, either open or closed, and results. Does this project fit into one of your division's operating strategies? State project objective(s) and expected results.

Under Federal law, marijuana (Cannabis) is a controlled substance and subject to deduction restrictions under section 280E, IRC. However, Colorado has passed legislation allowing cultivation, sales and possession of both medical and recreational marijuana. In 2014, 74 tons of marijuana flower were sold in Colorado, of which 19 tons were sold as "recreational." The Colorado marijuana industry has created approximately 16,000 jobs since it has become legalized. Even though Colorado law allows both medical and recreational use of marijuana, it still remains a very cash intensive industry.

Section 280E, IRC states there is no deduction or credits allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business consists of trafficking in controlled substances (within the meaning of schedule I or 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. Therefore, all operating expenses associated with the marijuana industry should be disallowed.

Even though Colorado law mandates strict regulations and licensing of this industry, preliminary search shows a high number of Federal non-filers. Another compliance concern is the accurate reporting of gross income. Because the industry is so cash intensive, the likelihood of an understatement is high.

There has been prior CIP projects on this issue. However, there is no project results that would either justify or not justify the pursuit of this latest project.

As a Part 1 CIP the project will be limited to thirty taxpayer contacts

- B. **MARKET SEGMENT:** Define the market segment. If a market segment is not predefined, provide a detailed description of the taxpayer group from which the market segment will be identified.

(b)(7)(E)

There is no NAICS code for this industry. The Colorado Department of Revenue does publish all licensed stores, cultivators (growers) and suppliers of infused products (edibles).

(b)(7)(E)



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - NARRATIVE (Continuation)

Project Name Section 280E Expenses - Marijuana Businesses

C. **DATA:** Identify data needed for the project and the source and an assessment of its accuracy. For external data, include expected delivery date(s), delivery media, amount of time the data will be held, method of storing/maintaining and ultimate destruction/disposition.

(b)(7)(E)

The Colorado Department of Revenue posts online list of licensed marijuana dispensaries and retail centers. Even though the data is from an external source, it is a public access. The data lists the business name, address and license number but no Federal tax ID. One business location can have more than one license, i.e. medical dispensary and recreational retail store.

(b)(7)(E)

Since there is no specific NAICS code for this industry, CDE will not be utilized to identify the inventory. IDRS and other internal resources will be used instead.

A training classes for section 280E expenditures is being organized for the end of March 2016. Case inventory is needed for these trained revenue agents.

D. **TIME FRAMES / ACTION PLAN:** List the tasks necessary to complete the project, estimated time to accomplish each task and the projected task completion dates. Action plan dates should be consistent with the final project completion date.

| RESPONSIBLE PARTY | ACTION PLAN  | COMPLETION DATE |
|-------------------|--|-----------------|
| PSP Staff         | Complete CIP and route for approval                            | 01/15/2016      |
| PSP Staff         | External information/Data requests                             | 01/31/2016      |
| PSP Staff         | Inventory identification, order returns and classify inventory | 02/28/2016      |
| SBSE Compliance   | Examination of returns   | 12/31/2016      |
| PSP Staff         | Monitoring   | Ongoing         |

# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE

Project Name: Section 280E Expenses - Marijuana Businesses

Date: 1/4/2016 Project Completion Date: 12/31/2016

Operating Division / Area / Industry/Compliance Center: SBSE Western Area Exam Initiating Function: PSP

Termination Report Due Date: 6/30/2017 MACS Identified Workload? ☐ Yes ☒ No

NAICS Code: (b)(7)(E) Project Code: (b)(7)(E) Uniform Issue Code: (b)(7)(E) ERCS Tracking Code (if applicable): (b)(7)(E)

Contact Person: Jake Riley (435) 634-5566  
(Coordinator) (Name) (Phone Number)

Form Type: (b)(7)(E)

Which one of your Operating Division's "Strategies" does this CIP support? (See instructions)

Increase compliance among SBSE taxpayers including under reporting and non-filers - (b)(7)(E)

If none, please justify (b)(7)(E)

### REVIEW and CONCURRENCE: (See instructions for each Operating Division)

|                              |                          |                 |
|------------------------------|--------------------------|-----------------|
| <u>PSP Territory Manager</u> | <u>Kenneth D. Cooper</u> | <u>2/9/2016</u> |
| Title                        | Signature                | Date            |
| <u>Disclosure Officer</u>    |                          |                 |
| Title                        | Signature                | Date            |
| <u></u>                      |                          |                 |
| Title                        | Signature                | Date            |
| <u></u>                      |                          |                 |
| Title                        | Signature                | Date            |
| <u></u>                      |                          |                 |
| Title                        | Signature                | Date            |
| <u></u>                      |                          |                 |
| Title                        | Signature                | Date            |

### Approval: (See instructions for each Operating Division and forward a copy to each respective Operating Division's CIP Program Analyst)

|                             |                        |                   |
|-----------------------------|------------------------|-------------------|
| <u>Acting Area Director</u> | <u>Kristin L. Bonn</u> | <u>02/09/2016</u> |
| Title                       | Signature              | Date              |

## PART ONE - EXTENSION

PROJECT EXTENSION\*: (b)(7)(E)  
Extension Date

### APPROVALS (See instructions for each Operating Division)

EXTENSION 6 MONTHS OR LESS:  
(Information copy to HQ CIP Program Analyst)

|                  |                  |                  |
|------------------|------------------|------------------|
| <u>(b)(7)(E)</u> | <u>(b)(7)(E)</u> | <u>(b)(7)(E)</u> |
| Title            | Signature        | Date             |
| <u>(b)(7)(E)</u> |                  |                  |
| Title            | Signature        | Date             |

### EXTENSION EXCEEDING 6 MONTHS:

|                  |                  |                  |
|------------------|------------------|------------------|
| <u>(b)(7)(E)</u> | <u>(b)(7)(E)</u> | <u>(b)(7)(E)</u> |
| Title            | Signature        | Date             |
| <u>(b)(7)(E)</u> |                  |                  |
| Title            | Signature        | Date             |

\* (Attach explanation why extension is required.)



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - Instructions

For your Operating Division's "Strategies" refer to the respective web site links below:

SB/SE Strategies - <http://sbse.web.irs.gov/srpm/>

LMSB Strategies - <http://lmsb.irs.gov/initiatives/initiatives.htm>

W&I Strategies - <http://win.web.irs.gov/strategy.htm>

Insert the titles and corresponding names for your division on the title line and under the signature line. The person then **must sign and date** the form.

### Under Review and Concurrence section

#### If **SB/SE - Compliance:**

CLD Stakeholder Liaison  
Disclosure Officer  
Other Affected Functions

#### If **SB/SE - Campus:**

Program Manager Workload Selection & Delivery  
Disclosure Officer  
CIP Headquarter Analyst

#### If **SB/SE - CLD:**

CLD Stakeholder Liaison  
Disclosure Officer  
Other Affected Functions  
PSP Territory Manager

If CIP originates in a headquarters function (other than EPD), it will be reviewed for concurrence by the Functional Director. Final Approval will be the Director, of Exam Planning & Delivery.

#### If **LMSB:**

Team Manager  
Territory Manager  
Applicable Director of Field Operation  
Disclosure Officer  
Designated CIP Headquarter/Industry Analyst or the PSP for Foreign  
Residence Compliance  
LMSB CIP Analyst

#### If **W&I:**

Disclosure Officer  
Headquarters Analyst

If the CIP originates in a headquarter office (including Field Specialists) then the CIP must be presented to the CIP Oversight Committee.

### For Approval Section

#### If **SB/SE - Compliance:**

PSP Territory Manager

#### If **SB/SE - Campus:**

Director, Reporting Compliance  
Exam Planning & Delivery

#### If **SB/SE - CLD:**

CLD Area Director

If the CIP originates in a headquarters function, it will be approved by the Director, Reporting Compliance or delegate.

#### If **LMSB:**

Operations Planning & Support Manager; Planning, Quality, Analysis & Support

#### If **W&I:**

Chief, Strategy and Selection or delegate

### For Extension Approvals section

#### If **SB/SE:**

##### 6 months or less

##### Compliance:

PSP Territory Manager

##### Campus:

Program Manager Workload Selection and Delivery  
Workload Planning & Analysis Program Manager

##### CLD:

CLD Area Director

##### 6 months or more

##### Compliance:

PSP Territory Manager  
Director, of Exam Planning & Delivery

##### Campus:

Field Director, Compliance Services or delegate  
Service Center Exam Program Manager  
Workload Planning & Analysis Program Manager  
Headquarters CIP Program Analyst  
Director, of Campus Reporting Compliance  
Director, of Exam Planning & Delivery

##### CLD:

CLD Area Director  
Director, of Exam Planning & Delivery

#### If **LMSB:**

Director of Field Operations/Director of International Compliance Strategy & Policy  
Operations Planning & Support Manager; Planning, Quality, Analysis & Support

#### If **W&I:**

Chief, Strategy and Selection or delegate

Forward a copy of all Extensions to the SB/SE CIP Program Analyst.



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - NARRATIVE

Project Name Section 280E Expenses - Marijuana Businesses

- A. **BACKGROUND and OBJECTIVES:** Provide information that will be useful for a better understanding of the proposed project. State issues, how identified, and impact on compliance. Describe sources used to determine duplicate or similar projects, either open or closed, and results. Does this project fit into one of your division's operating strategies? State project objective(s) and expected results.

Under Federal law, marijuana (Cannabis) is a controlled substance and subject to deduction restrictions under section 280E, IRC. However, Colorado has passed legislation allowing cultivation, sales and possession of both medical and recreational marijuana. In 2014, 74 tons of marijuana flower were sold in Colorado, of which 19 tons were sold as "recreational." The Colorado marijuana industry has created approximately 16,000 jobs since it has become legalized. Even though Colorado law allows both medical and recreational use of marijuana, it still remains a very cash intensive industry.

Section 280E, IRC states there is no deduction or credits allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business consists of trafficking in controlled substances (within the meaning of schedule I or 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. Therefore, all operating expenses associated with the marijuana industry should be disallowed.

Even though Colorado law mandates strict regulations and licensing of this industry, preliminary search shows a high number of Federal non-filers. Another compliance concern is the accurate reporting of gross income. Because the industry is so cash intensive, the likelihood of an understatement is high.

There has been prior CIP projects on this issue. However, there is no project results that would either justify or not justify the pursuit of this latest project.

As a Part 1 CIP the project will be limited to thirty taxpayer contacts

- B. **MARKET SEGMENT:** Define the market segment. If a market segment is not predefined, provide a detailed description of the taxpayer group from which the market segment will be identified.

(b)(7)(E)

There is no NAICS code for this industry. The Colorado Department of Revenue does publish all licensed stores, cultivators (growers) and suppliers of infused products (edibles).

(b)(7)(E)



# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE - NARRATIVE (Continuation)

Project Name Section 280E Expenses - Marijuana Businesses

C. **DATA:** Identify data needed for the project and the source and an assessment of its accuracy. For external data, include expected delivery date(s), delivery media, amount of time the data will be held, method of storing/maintaining and ultimate destruction/disposition.

(b)(7)(E)

The Colorado Department of Revenue posts online list of licensed marijuana dispensaries and retail centers. Even though the data is from an external source, it is a public access. The data lists the business name, address and license number but no Federal tax ID. One business location can have more than one license, i.e. medical dispensary and recreational retail store.

(b)(7)(E)

Since there is no specific NAICS code for this industry, CDE will not be utilized to identify the inventory. IDRS and other internal resources will be used instead. The process begins with downloading the list of licensees from Colorado Department of Revenue.

A training classes for section 280E expenditures is being organized for the end of March 2016. Case inventory is needed for these trained revenue agents.

D. **TIME FRAMES / ACTION PLAN:** List the tasks necessary to complete the project, estimated time to accomplish each task and the projected task completion dates. Action plan dates should be consistent with the final project completion date.

| RESPONSIBLE PARTY | ACTION PLAN  | COMPLETION DATE |
|-------------------|--|-----------------|
| PSP Staff         | Complete CIP and route for approval                            | 01/15/2016      |
| PSP Staff         | External information/Data requests                             | 01/31/2016      |
| PSP Staff         | Inventory identification, order returns and classify inventory | 02/28/2016      |
| SBSE Compliance   | Examination of returns   | 12/31/2016      |
| PSP Staff         | Monitoring   | Ongoing         |

# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

## PART ONE

Project Name: \_\_\_\_\_ Section 280E Expenses - Marijuana Businesses

Date: 1/4/2016 Project Completion Date: 12/31/2016

Operating Division / Area / Industry/Compliance Center: SBSE Western Area Exam Initiating Function: PSP

Termination Report Due Date: 6/30/2017 MACS Identified Workload? ☐ Yes ☒ No

NAICS Code: \_\_\_\_\_ Project Code: \_\_\_\_\_ Uniform Issue Code: \_\_\_\_\_ ERCS Tracking Code (if applicable): \_\_\_\_\_

Contact Person: Jake Riley (435) 634-5566  
(Coordinator) (Name) (Phone Number)

Form Type: \_\_\_\_\_

Which one of your Operating Division's "Strategies" does this CIP support? (See instructions)

Increase compliance among SBSE taxpayers including under reporting and non-filers - \_\_\_\_\_

If none, please justify \_\_\_\_\_

### REVIEW and CONCURRENCE: (See instructions for each Operating Division)

PSP Territory Manager

Title

Signature

Date

Disclosure Officer

SWBBB

Digitally signed by SWBBB  
DN: cn=SWBBB, email=swbbb@irs.gov,  
c=US, o=IRS, ou=IRS

1-25-2016

Title

Signature

Date

Title

Signature

Date

Title

Signature

Date

Title

Signature

Date

Title

Signature

Date

**Approval:** (See instructions for each Operating Division and forward a copy to each respective Operating Division's CIP Program Analyst)

Acting Area Director

Title

Signature

Date

## PART ONE - EXTENSION

PROJECT EXTENSION\*: \_\_\_\_\_

Extension Date

**APPROVALS** (See instructions for each Operating Division)

**EXTENSION 6 MONTHS OR LESS:**

(Information copy to HQ CIP Program Analyst)

Title

Signature

Date

Title

Signature

Date

**EXTENSION EXCEEDING 6 MONTHS:**

Title

Signature

Date

Title

Signature

Date

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# COMPLIANCE INITIATIVE PROJECT AUTHORIZATION

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If **W&I:**

Chief, Strategy and Selection or delegate

### For Extension Approvals section

If **SB/SE:**

**6 months or less**

**Compliance:**

PSP Territory Manager

**Campus:**

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Workload Planning & Analysis Program Manager

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Field Director, Compliance Services or delegate  
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Workload Planning & Analysis Program Manager  
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CLD Area Director  
Director, of Exam Planning & Delivery

.....  
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Project Name Section 280E Expenses - Marijuana Businesses

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| SBSE Compliance   | Examination of returns   | 12/31/2016      |
| PSP Staff         | Monitoring   | Ongoing         |

Withheld pursuant to exemption

(b)(3) 26 U.S.C. § 6103

of the Freedom of Information and Privacy Act



# Compliance Initiative Project Termination Report

Function/Division

SBSE-EXAM

Area/Industry

Western PSP

Requesting function

Western PSP-CIP Coordinator

(b)(7)(E)

Project name

Section 280E Expenses Marijuana Businesses

Project code

0182

Termination date

6/30/2017

## Project Results

Number of returns examined

103

3

29

35

Number of returns no-changed

4

0

(b)(3) 26 U.S.C. § 6103

Number of returns surveyed

0

0

0

0

Average time per return

17.26

55

49

52.1

Avg. deficiency or adj (1065, 1120s)

120,301

21,251,611

331,902

576,323

## Other results

1.

2.

3.

Number of referrals to CI

Number of Joint Investigations from referrals

Were the issues that created the CIP identified and adjusted in the examinations

☒ Yes

☐ No

If not, was there a common factor for the discrepancies? If yes, explain.

☐ Yes

☒ No

N/A

If not, was there anything learned from the CIP that would help to refine or improve the selection process? If yes, explain.

☐ Yes

☐ No

N/A

Based on the results of the CIP to include feedback from examiners, productivity, etc., should this issue be addressed further by the Service? If yes, explain.

☒ Yes

☐ No

Wide variety of expenses that are included in COGs that were determined to be non-deductible expenses as well as expenses deducted that were subject to IRC 280e.

Identify the potential opportunities for the Service to address the issue further. For example, additional examinations, soft notices, correspondence examinations, taxpayer/preparer education, legislative changes, form changes, and/or publications changes.

Expansion of CIP into national CIP as well as taxpayer/preparer education.

Did the results of the project justify the time and resources spent? Explain.

☒ Yes

☐ No

Significant compliance issues were addressed based upon current legislation, examination results were substantial based upon time spent on exams.


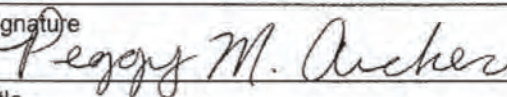

What difficulties were encountered and how were they resolved

Risk of targeting a specific industry that is high profile. Risk was discussed and monitored via senior management. Training provided to examiners on issues to maintain consistency in exams.



Describe successful procedures and/or audit techniques used

Developed training for examiners. Developed program specialist to review closed case. Held regular meeting with examiners. Council involved in developing exam guidelines.

|   |   |   |
|---|---|---|
| Project Coordinator ( <i>printed name</i> )<br>Scott Mintken          | Signature<br> | Telephone number<br>303-603-4785            |
|   | Title<br>CIP Coordinator-Western  | Date<br>6/20/2018                           |
| Project Approving Official ( <i>printed name</i> )<br>Peggy M. Archer | Signature<br> | Telephone number<br>303-603-4736            |
|   | Title<br>PSP Section Chief  | Date<br>7/2/18                              |
| Project Approving Official ( <i>printed name</i> )<br>Ken Cooper      | Signature<br> | Telephone number<br><del>303-603-4736</del> |
|   | Title<br>PSP TM   | Date<br>7-2-2018                            |

### Instructions for Form 13497, Compliance Initiative Project Termination Report IRM 4.17.4.7

Compliance Initiative Projects should be terminated prior to the authorized completion date when any of the following conditions have been met:

- Noncompliance has been addressed
- Results do not justify time spent
- Resources are no longer available
- Other circumstances indicate that the project is no longer viable

A termination report must be submitted when substantially all cases have closed but no later than 60 days after the project completion date including extensions.

Project Terminations reports should be sent to the Headquarters CIP Program Analyst.

#### Project Approving Official

The termination report will be prepared by the CIP coordinator and signed by the approver of the CIP outlined in IRM 4.17.4.3.5 Review, Concurrence and Approval of Part One CIP Only or IRM 4.17.4.4.4 Review, Concurrence and Approval Part Two Authorization Requests.