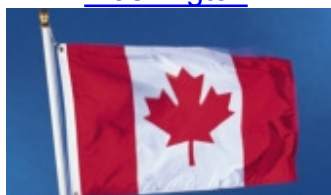


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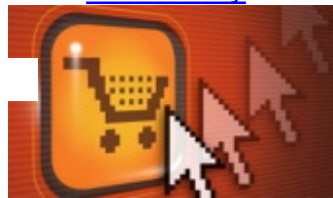
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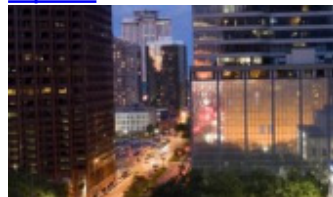
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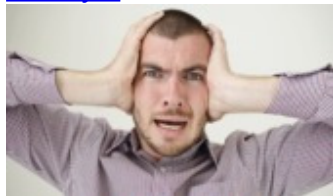
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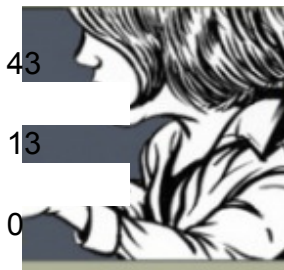
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0Years ago, I found myself sitting in law school in Moot Court wearing an oversized itchy blue suit. It was a horrible experience. In a desperate attempt to avoid anything like that in the future I enrolled in a tax course. I loved it. I signed up for another. Before I knew it, in addition to my JD, I had a LL.M Taxation. I needed only to don my cape.... taxgirl® was born. Today, I live and work in Philadelphia, PA, one of the best cities in the world (I can't even complain about the sports teams these days). I landed in the City of Brotherly Love by way of Temple University School of Law. While at law school, I

The author is a Forbes contributor. The opinions expressed are those of the writer.

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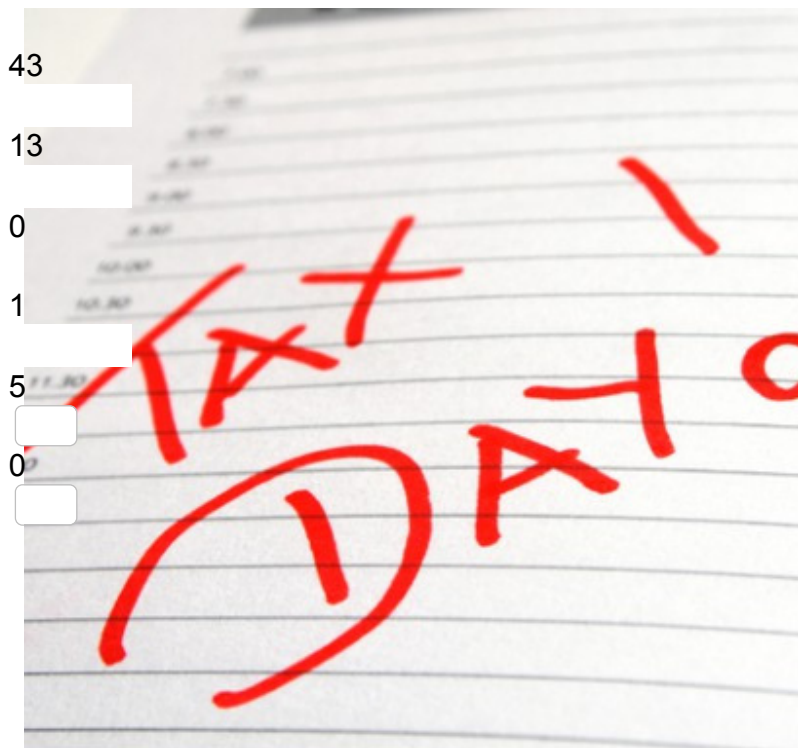
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Our culture is fascinated with marijuana. We speak in hushed tones about cocaine and other “hard” drugs but we’re pretty outspoken about marijuana. It’s even become a question bandied about during presidential campaigns with former President Bill Clinton famously saying that he “didn’t inhale and never tried inhaling again” [prompting one MTV viewer to ask during a 2000 town hall style meeting](#), “If you had it to do over again, would you inhale?” (For the record, the answer was: “Sure, if I could, I tried before.”)

Perhaps part of the fascination is that the drug is widely available – and routinely used – even though it’s not legal. Well, sort of not legal.



[Gallery: 15 Ways To Invite An IRS Audit](#)

As of this writing, [sixteen states and D.C. have legalized marijuana for medical purposes](#). They are: Alaska, Arizona, California, Colorado, Delaware, Hawaii, Maine, Michigan, Montana, Nevada, New Jersey, New Mexico, Oregon, Rhode Island, Vermont and Washington.

The first state to legalize marijuana for medical purposes was California in 1996. Just over ten years later, then [Governor of California Arnold Schwarzenegger made international headlines](#) when he said, reflecting the thoughts of many:

That is not a drug. It's a leaf.

But no matter what Schwarzenegger or others think, [marijuana is still illegal on the federal level](#). That includes marijuana prescribed for medical purposes. That's because, under federal law, marijuana is still classed as a Schedule I drug. This means that it cannot actually be prescribed (to get it in most states where it's legal, you need a note, not a prescription, from a doctor).

So, marijuana is legal for *some* purposes in *some* states but largely remains illegal across the country. That makes taxing it tricky. In fact, [it was the taxation of marijuana in the 1930s which lead to the criminalization of the drug in the first place](#).

In 2009, Oakland gave it a try: [it became the first city in the country to tax marijuana](#). The tax, which is imposed on the dispensaries which are licensed to sell medical marijuana, is still controversial: taxing a product is often perceived as the government's tacit approval of the sale of the product. But only at the state level.

The feds tax nearly everything, legal or not. The IRS requires that you report "[all income from whatever source derived](#)" – unless otherwise excepted. That includes all illegal activities: from [illegal gambling](#) to [prostitution](#) to [kickbacks](#). The IRS actually has a program, the Illegal Source Financial Crimes Program, that attempts to enforce taxation rules on income obtained through illegal operations which would otherwise be part of the "untaxed underground economy."

In keeping with those rules, [Harborside Health Center](#) dutifully reported its income. The San Francisco area medical marijuana dispensary filed and paid taxes on an estimated \$22 million annual income.

And then, according to Harborside's CEO, Steve Deangelo, came the audit. I spoke to Deangelo and he explained that initially, Harborside received an examination notice from IRS for two years, 2007 and 2008. Deangelo said that Harborside cooperated with the audit, even giving the auditor a tour of the facilities. The IRS accepted the company's financial records with no additional questions. And then, the IRS sent the dispensary a \$2.4 million bill.

What did Harborside do wrong? Hide income? Claim bogus expenses? Underreport compensation to executives?

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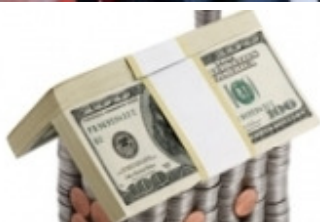
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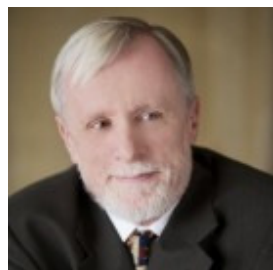
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The tax law is pretty clear. Why they were selected for audit might be a question but once they were I don't see how the IRS could just let it go. If medical marijuana is a 1.7 billion industry, somebody is going to get audited eventually. The Code seems to be pretty clear. How can the IRS do anything other than assess ?

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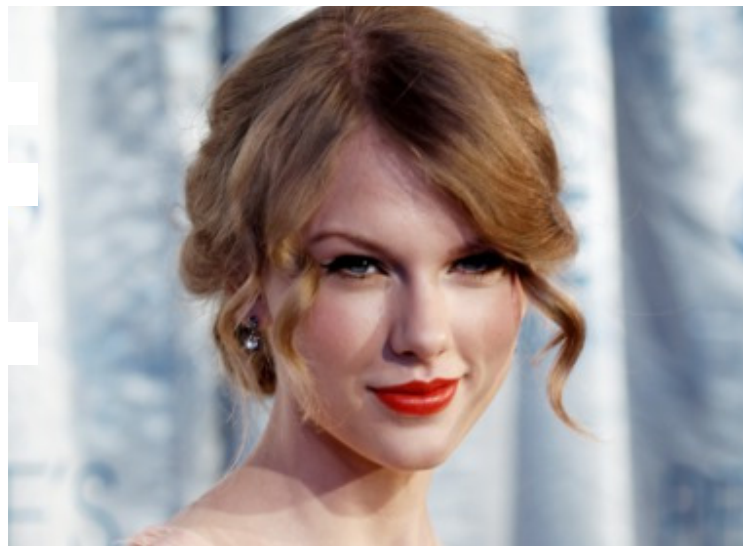
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