No. 18-1122

In the Supreme Court of the United States

ALPENGLOW BOTANICALS, LLC, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

The Internal Revenue Code prohibits allowing any tax deduction or credit for business expenditures incurred in carrying on a trade or business that "consists of trafficking in controlled substances" in violation of federal law. 26 U.S.C. 280E. The questions presented are as follows:

1. Whether the Internal Revenue Service is authorized, for purposes of applying Section 280E, to investigate and determine whether a business is claiming a deduction for expenses incurred in illegal trafficking in a controlled substance.

2. Whether petitioner's inability to take a tax deduction as a result of the application of Section 280E constitutes an excessive fine in violation of the Eighth Amendment.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases—Continued: Page

Constitution, statutes, and regulation:

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-35) is reported at 894 F.3d 1187. The opinion and order of the district court (Pet. App. 36-56) is not published in the Federal Supplement but is available at 2016 WL 7856477. An additional order of the district court (Pet. App. 57-65) is not published in the Federal Supplement but is available at 2017 WL 1545659.

JURISDICTION

The judgment of the court of appeals was entered on July 3, 2018. A petition for rehearing was denied on September 25, 2018 (Pet. App. 66). On December 21, 2018, Justice Sotomayor extended the time within which to file a petition for a writ of certiorari to and including February 22, 2019, and the petition was filed on February 21, 2019. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Internal Revenue Code (Code), 26 U.S.C. 1 *et seq.*, imposes a tax on the "taxable income" of every individual and every corporation. 26 U.S.C. 1 and 11(a). "Taxable income" means "gross income minus the deductions allowed by this chapter." 26 U.S.C. 63(a). "Gross income" in turn means "all income from whatever source derived," including "[g]ross income derived from business." 26 U.S.C. 61(a) and (2). For a business, gross income is calculated as its "total sales, less the cost of goods sold." 26 C.F.R. 1.61-3(a).

The Code separately provides for various tax deductions. See, *e.g.*, 26 U.S.C. 38-45S, 161-199A, 241-250. Among others, the Code provides a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business," including, for example, reasonable costs of salaries, benefits, and rent. 26 U.S.C. 162(a)(1) and (3).

The Code expressly provides, however, that some costs are not deductible. As relevant here, the Code states that "[n]o deduction or credit shall be allowed for any amount paid or incurred" in carrying on a trade or business that "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." 26 U.S.C. 280E. The Controlled Substances Act, 21 U.S.C. 801 *et seq.*, classifies marijuana as a Schedule I controlled substance and makes it illegal to knowingly or intentionally "manufacture, distribute, or dispense" it. 21 U.S.C. 812(c) (Sched. I(c)(10)), 841(a)(1). That prohibition applies nationwide,

including in States that do not impose any state-law prohibition on the sale of marijuana. See *Gonzales* v. *Raich*, 545 U.S. 1, 29 (2005).

For example, if a business pays $600,000 for marijuana in a year and sells that marijuana for $1 million (in violation of the federal Controlled Substances Act but consistent with state law), it must pay federal income tax on its gross income of $400,000, even if the business also incurred $100,000 in ordinary business expenses for costs like salaries, benefits, and rent. In those circumstances, Section 162(a) would ordinarily allow a business to take a $100,000 deduction, but Section 280E would prohibit the deduction because the business consists of trafficking in a controlled substance.

2. Petitioner Alpenglow Botanicals is a medical-marijuana dispensary in Colorado, operating consistent with state law. Pet. App. 3. This case arises from an Internal Revenue Service (IRS) audit of Alpenglow's 2010, 2011, and 2012 tax returns. *Ibid.* In those returns, Alpenglow claimed a variety of business deductions, including for its ordinary and necessary business expenses, and the IRS determined that these business deductions were precluded by Section 280E. *Ibid.* Because Alpenglow is a pass-through entity for tax purposes, the IRS's denial of the business deductions resulted in increased tax liability for its owners, petitioners Charles and Justin Williams, of $24,133 and $28,961 respectively. *Id.* at 4.[1] Petitioners paid the tax and filed administrative refund claims, challenging the application of Section 280E. *Id.* at 41. The claims were denied. *Ibid.*

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[1] The official caption identifies only Alpenglow as the petitioner, but Charles and Justin Williams also are identified as petitioners in the petition for a writ of certiorari. See Pet. (cover).

Petitioners filed this refund suit in the United States District Court for the District of Colorado. They argued that, for purposes of applying Section 280E, the IRS lacked the authority to determine whether they had trafficked in a controlled substance. They also contended that Section 280E violates the Fifth, Eighth, and Sixteenth Amendments. Pet. App. 4, 51-52.

3. The district court granted the government's motion to dismiss. Pet. App. 36-56.

a. The district court held that the IRS was authorized to enforce Section 280E. Pet. App. 43-47. It explained that the statute did not require the IRS to conduct any criminal investigation or prosecution. *Id.* at 43-44. The court held that Section 280E merely required the IRS to determine whether petitioners carried on a trade or business that regularly buys or sells a controlled substance. *Id.* at 44. Because there was no dispute that petitioners have carried on a trade or business or that marijuana is a controlled substance, the only question the IRS was required to answer was whether petitioners regularly bought or sold marijuana. *Ibid.*

The district court concluded that the IRS was competent to answer that question. The court observed that making the necessary determination "should simply require a perusal of [petitioners'] receipts, or even a visit to [petitioners'] business establishment." Pet. App. 45. The court noted that Section 280E is a provision of the Internal Revenue Code and that it "would certainly be strange" if the IRS "was not charged with enforcing" it. *Ibid.* The court further held that the IRS can determine "that a taxpayer has engaged in illegal activity" without transforming the IRS's enforcement of the tax laws "into a criminal investigation, a criminal prosecution, or somehow the rendering of a criminal verdict." *Id.* at 46.

b. The district court rejected petitioners' constitutional arguments. It held that the Sixteenth Amendment does not require "gross income" to exclude not only the cost of goods sold, but also other ordinary and necessary business expenses. Pet. App. 48-49. The district court explained that, under this Court's precedents, "deductions 'depend[] upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.'" *Id.* at 49 (quoting *Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974)) (brackets in original). The court further held that the IRS had not violated the Fifth Amendment by failing to inform petitioners that they were being criminally investigated, because the IRS audit was not a criminal investigation. *Id.* at 51-52. The court rejected petitioners' Eighth Amendment claim because the amended complaint contained no allegations pertaining to Section 280E's effect. *Id.* at 52. The court concluded on that basis that, even if Section 280E could amount to a "penalty," petitioners had provided no factual basis to "assess whether such a penalty would be excessive." *Ibid.*

c. The district court denied petitioners' subsequent motion to alter or amend the judgment. Pet. App. 58-63. The court declined to consider various newly-raised issues, and denied as untimely a request for leave to further amend the complaint. *Ibid.* The court explained that petitioners' arguments about whether an illegal business can have ordinary and necessary expenses provided no reason to alter the judgment. *Id.* at 63-65.

4. The court of appeals affirmed. Pet. App. 1-35. The court first held that the IRS was authorized to enforce Section 280E. Noting that it had rejected substantially the same challenge in *Green Solution Retail,*

Inc. v. *United States*, 855 F.3d 1111 (10th Cir. 2017), cert. denied, 138 S. Ct. 1281 (2018), the court explained that Section 280E does not require a predicate criminal conviction. Pet. App. 9-11. The court also held that "it is within the IRS's statutory authority to determine, as a matter of civil tax law, whether taxpayers have trafficked in controlled substances," and that the IRS therefore had acted within its authority in denying Alpenglow's business deductions under Section 280E. *Id.* at 14. The court further determined that petitioners had the burden of showing that they were entitled to the deductions they claimed, and that petitioners had failed to meet that burden because they had not proffered any credible evidence that Alpenglow was not engaged in marijuana trafficking. *Id.* at 14-15.

The court of appeals also rejected petitioners' constitutional arguments. The court held that there is no Sixteenth Amendment right to deduct ordinary and necessary business expenses, and that such deductions are distinct from the mandatory exclusion from gross income of the cost of goods sold. Pet. App. 16-24. The court also held, as it had previously in *Green Solution Retail*, that Section 280E does not violate the Eighth Amendment because it is not a penalty. *Id.* at 25. Finally, the court of appeals concluded that "the district court did not abuse its discretion in refusing to allow Alpenglow to amend its complaint." *Id.* at 29.

ARGUMENT

Petitioners contend that the IRS lacks authority to determine whether the tax deductions they claimed on their 2010, 2011, and 2012 federal tax returns are precluded by 26 U.S.C. 280E. Pet. 11-30. Petitioners also argue that Section 280E is a penalty for purposes of the Eighth Amendment. Pet. 30-31. The court of appeals

correctly rejected those arguments, and its decision does not conflict with any decision of this Court or another court of appeals. This Court recently denied a petition for certiorari that presented the same question concerning the IRS's authority to enforce Section 280E. See *Green Solution Retail, Inc.* v. *United States*, 138 S. Ct. 1281 (2018) (No. 17-663). There is no reason for a different result here.

1. The court of appeals correctly held that the IRS is authorized to implement and enforce Section 280E.

a. Section 280E is one of several Internal Revenue Code provisions that identify types of expenses that may not be deducted "[i]n computing taxable income." 26 U.S.C. 261. It provides that "[n]o deduction or credit shall be allowed" for expenses incurred in connection with "any trade or business" that "traffic[s] in controlled substances" in violation of federal or state law. 26 U.S.C. 280E. Section 280E thus regulates the calculation of income and income-tax liability under the Internal Revenue Code.

Congress has authorized the IRS to make "inquiries, determinations, and assessments of all taxes" imposed by the Code, 26 U.S.C. 6201(a); to conduct audits and investigations to ensure that those taxes are accurately assessed, 26 U.S.C. 7601(a), 7602; and to request from taxpayers "books, papers, records, or other data" that are relevant to "ascertaining the correctness of any return," "determining the liability of any person for any internal revenue tax," and "collecting any such liability," 26 U.S.C. 7602(a). Those grants of authority clearly encompass IRS efforts to investigate and determine whether particular deductions or credits should be disallowed under Section 280E. See, *e.g.*, *Feinberg* v.

Commissioner, 916 F.3d 1330, 1331 (10th Cir. 2019) (upholding tax deficiency for medical-marijuana dispensary based on the application of Section 280E); *Canna Care, Inc.* v. *Commissioner*, 694 Fed. Appx. 570 (9th Cir. 2017) (same); *Olive* v. *Commissioner*, 792 F.3d 1146, 1150 (9th Cir. 2015) (same); see also *High Desert Relief, Inc.* v. *United States*, 917 F.3d 1170, 1178-1194 (10th Cir. 2019) (upholding the IRS's authority to issue summonses to third parties in order to determine whether Section 280E bars a marijuana dispensary's claimed tax deductions); *Green Solution Retail, Inc.* v. *United States*, 855 F.3d 1111, 1114-1121 (10th Cir. 2017) (ruling that the Anti-Injunction Act, 26 U.S.C. 7421, precludes a marijuana dispensary from seeking to enjoin an IRS investigation to determine Section 280E's applicability), cert. denied, 138 S. Ct. 1281 (2018).

b. Petitioners assert (Pet. 11-14) that the court of appeals' decision empowers the IRS to define the scope of federal drug laws and determine taxpayers' criminal liability under those laws. But the IRS's administration of Section 280E does no such thing. Congress has defined the federal drug offenses in the Controlled Substances Act, see 21 U.S.C. 812(c), and Section 280E does not authorize the IRS to add or remove substances to or from the ambit of the Controlled Substances Act. Section 280E merely provides that a business that traffics in illegal drugs in violation of federal law cannot deduct its ordinary and necessary business expenses when calculating its gross income for purposes of federal income taxation. And there can be no serious doubt that Alpenglow bought and sold a drug in violation of federal law: It is a marijuana dispensary.

The decisions on which petitioners rely do not support their position. Both *United States* v. *Grimaud*,

220 U.S. 506 (1911), and *United States* v. *Eaton*, 144 U.S. 677 (1892), concern Congress's ability to delegate to an agency the authority to define a criminal offense. See *Grimaud*, 220 U.S. at 518-519 (citing *Eaton*, 144 U.S. at 688). But as explained above, Congress has defined federal drug offenses in the Controlled Substances Act. The relevant Internal Revenue Code provisions do not authorize the IRS to initiate or conduct criminal prosecutions under the Controlled Substances Act, but simply authorize the agency to determine, for civil tax purposes, whether taxpayers may claim credits or deductions for particular expenses. The fact that this inquiry turns in part on whether a business's activities are among those Congress has prohibited does not mean that the IRS is enforcing the criminal laws as such. And, like other IRS tax-assessment decisions, any IRS determination that Section 280E bars particular tax credits or deductions is judicially reviewable in a taxpayer's challenge to a consequent finding of a tax deficiency.

Petitioners are also wrong in asserting (Pet. 15-17) that the court of appeals' interpretation of Section 280E causes a statute to have two different meanings at the same time. Cf. *Clark* v. *Martinez*, 543 U.S. 371, 380 (2005). This case does not involve multiple constructions of Section 280E. It is undisputed that marijuana is a controlled substance "within the meaning of schedule I and II of the Controlled Substances Act" and that trafficking in marijuana "is prohibited by Federal law." 26 U.S.C. 280E. Petitioners' challenge appears to rest on the fact that trafficking in controlled substances has independent consequences for both civil tax liability and potential criminal exposure. But that is the direct result of Congress's decisions to enact both the Controlled

Substances Act (making marijuana trafficking a crime subject to criminal penalties) and Section 280E (prohibiting tax deductions for ordinary and necessary business expenses incurred by a business that traffics in controlled substances, including marijuana).

The IRS's determination that Section 280E applies to a particular taxpayer does not have preclusive effect in any Controlled Substances Act prosecution that might be brought against that taxpayer or a related person. In any criminal prosecution under the Controlled Substances Act, the government bears the burden of establishing each element of the crime beyond a reasonable doubt. See *Apprendi* v. *New Jersey*, 530 U.S. 466, 499-500 (2000). In civil tax proceedings, by contrast, the IRS's tax assessments generally are presumed correct, and a taxpayer who challenges an assessment must show that the assessment is arbitrary, excessive, or without foundation. See *Helvering* v. *Taylor*, 293 U.S. 507, 515 (1935); see also, *e.g.*, *In re Olshan*, 356 F.3d 1078, 1084 (9th Cir. 2004). Accordingly, even under ordinary civil preclusion principles, the IRS's application of Section 280E would not be binding in a future criminal prosecution for drug trafficking. Cf. Restatement (Second) of Judgments § 28(4) (1982) (no issue preclusion in a subsequent matter if the party seeking preclusion bears a "significantly heavier burden").

Contrary to petitioners' assertion (Pet. 22), this Court's decisions in *Yakus* v. *United States*, 321 U.S. 414 (1944), and *Cox* v. *United States*, 332 U.S. 442 (1947), do not establish a broad rule that "[w]hen an agency has jurisdiction to make findings of fact and conclusions of law in an area, such findings are binding upon the subsequent criminal prosecution of the same facts and may not be retried de novo." In *Yakus*, for

example, the question whether the defendants had violated a wartime price regulation was submitted to the jury. See 321 U.S. at 448. And while the defendants were not allowed to challenge the validity of the underlying regulation in the criminal trial, that was not because of any broad principle of issue preclusion in criminal cases, but because Congress had established an alternative mechanism for judicial review of such pricing regulations and had declared that mechanism to be exclusive. *Id.* at 431-435; see Administrative Orders Review Act, ch. 1189, 64 Stat. 1129. No such channeling provision applies here.

Petitioners' reliance on *United States* v. *Peters*, 153 F.3d 445 (7th Cir. 1998), cert. denied, 525 U.S. 1070 (1999), and *United States* v. *Grunewald*, 987 F.2d 531 (8th Cir. 1993), is also misplaced. In those cases, courts found that the IRS had "engaged in impermissible deception" by conducting criminal tax investigations under the guise of civil tax audits, and that this deceptive conduct was relevant to the disposition of the defendants' motions to suppress in subsequent criminal prosecutions. *Peters*, 153 F.3d at 453; see *Grunewald*, 987 F.2d at 534 (suppression justified where "there is clear and convincing evidence that the IRS affirmatively and intentionally misled the defendant"). Those decisions do not suggest that the IRS must halt a *civil* tax investigation whenever it learns that a taxpayer has earned money through illegal activities or businesses, or that the agency is barred from basing civil tax determinations on such evidence). Cf. *Department of Revenue* v. *Kurth Ranch*, 511 U.S. 767, 778 (1994) ("[T]he unlawfulness of an activity does not prevent its taxation.").

c. Petitioners' remaining arguments lack merit.

i. Contrary to petitioners' contention (Pet. 25-30), this case does not implicate any concern about self-incrimination. Section 280E does not force a taxpayer to turn over incriminating information to the IRS. If a taxpayer attempts to take business deductions or credits and the IRS denies them based on Section 280E, the taxpayer need not turn over to the IRS any information that would establish that he trafficked in controlled substances in violation of federal law. The taxpayer could accept the IRS's denial of the deduction, dispute it with evidence that his business does not consist of illegal drug trafficking, or (as petitioners have) challenge Section 280E's legality or enforceability. None of those options requires the taxpayer to turn over incriminating information to the IRS.

As the court of appeals correctly held (Pet. App. 13), this case is "easily distinguishable" from *Leary* v. *United States*, 395 U.S. 6 (1969), *Grosso* v. *United States*, 390 U.S. 62 (1968), and *Marchetti* v. *United States*, 390 U.S. 39 (1968). In *Leary*, for example, the Court held that the Fifth Amendment privilege against compelled self-incrimination barred a criminal prosecution for failing to notify the IRS of taxable marijuana transactions that were themselves illegal. 395 U.S. at 16-18, 27. That decision, however, involved an excise tax imposed under the now-repealed Marihuana Tax Act of 1937, ch. 553, 50 Stat. 551, see *Leary*, 395 U.S. at 14-15, not deductions from gross income that a taxpayer voluntarily chose to claim on its tax return. Because petitioners were not compelled to claim those deductions, and "the burden of clearly showing the right to [a] claimed deduction is on the taxpayer," *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, 593 (1943), any objection on grounds of self-

incrimination would not save petitioners from a deficiency determination. Petitioners' concerns about the possibility of self-incrimination also ring hollow, as they operate a marijuana dispensary and thus hold themselves out publicly as trafficking in marijuana.

ii. Petitioners' arguments (Pet. 20-22) about deference under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), are beside the point. The government has not sought *Chevron* deference to any agency interpretation of Section 280E or of the Controlled Substances Act, and neither of the courts below granted such deference.

2. The court of appeals also correctly rejected petitioners' argument that the denial of a tax deduction due to the operation of Section 280E constitutes the imposition of an "excessive fine[]," in violation of the Eighth Amendment. See U.S. Const. Amend. VIII. The Excessive Fines Clause "limits the government's power to extract payments, whether in cash or in kind, 'as punishment for some offense.'" *Timbs* v. *Indiana*, 139 S. Ct. 682, 687 (2019) (quoting *United States* v. *Bajakajian*, 524 U.S. 321, 327-328 (1998)). But the denial of a tax deduction "is not an exaction imposed as a punishment" for any offense, because it does not involve punishment at all. It merely reflects Congress's decision not to extend a tax benefit as a matter of legislative grace. Pet. App. 25; see *Green Solution Retail*, 855 F.3d at 1111. Indeed, petitioner cites no decision of any court holding that the denial of a business deduction constitutes a "penalty" or "fine" for purposes of the Eighth Amendment. In any event, even if the restrictions on business deductions imposed by Section 280E were deemed a penalty or fine, petitioners failed

to preserve any argument that it was "excessive." See Pet. App. 52.

3. Petitioners do not assert that the court of appeals' decision conflicts with any decision of this Court or another court of appeals. For the reasons set forth above, the court of appeals' decision is clearly correct. The Court recently denied certiorari in *Green Solution Retail, Inc.* v. *United States*, 138 S. Ct. 1281 (2018) (No. 17-663), in which the petitioners had raised substantially the same challenges to the IRS's enforcement of Section 280E that petitioners raise in this case. Further review is unwarranted here as well.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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