As states legalize marijuana, more marijuana businesses are opening across the country. An obscure 1982 brainchild of Bob Dole’s Senate Finance Committee, section 280E of the federal tax code, is hitting state-legal marijuana sellers in the pocketbook—right now. 280E, which says taxpayers cannot deduct costs of selling federally illegal drugs, is not just helping fund the federal government. It’s also hampering marijuana advertising and marketing—to the satisfaction of nervous parents, and to the consternation of profit-seeking marijuana promoters.

280E was more a political statement than a model of tax policy, and it can’t eliminate marijuana advertising. But it does discourage that advertising, so it may be one of the most useful marijuana tax laws we can imagine. And while some anti-advertising proposals run afoul of the commercial free speech
doctrine, 280E is constitutional. So 280E may help slow down Big Marijuana. If so, an anti-advertising tax rule like 280E might come in handy if the public ever musters the strength to take on Big Alcohol and Big Tobacco.

How 280E makes marijuana ads non-tax-deductible

Federal Internal Revenue Code Section 280E says taxpayers “trafficking in controlled substances” get “no deduction” for many expenses. 280E denies deductions to sellers of all *federally* illegal drugs, so it hits all marijuana sellers, even when they are scrupulously following state medical or recreational marijuana laws. Remember that although marijuana is illegal under federal law, pot sellers still owe full federal income tax. (Not paying tax is how Al Capone went to jail.)

State-legal marijuana sellers do get to deduct “cost of goods sold”—the costs of making or buying the product they sell—as well as state taxes and fees. But when they fill out their 1040s, marijuana sellers suffer an unusual penalty: They can’t deduct the cost of marijuana advertising on their federal returns. (They lose other deductions, too; more about those below.)

Section 280E came into the tax code in 1982, as two
factors converged. First, the pendulum of opinion had swung in favor of the War on Drugs; second, the Reagan Administration was working with the congressional tax-writing committees, House Ways and Means and Senate Finance, to enact a package of revenue gainers, or “enhancements,” that eventually became TEFRA—the Tax Equity and Fiscal Responsibility Act of 1982. Senator Bob Dole’s Finance Committee noticed a Tax Court case that allowed a drug dealer to deduct selling expenses. That committee, and then the full Congress, decided to make selling expenses of drug dealers nondeductible. The 280E provision was so politically bulletproof that no committee bothered to hold hearings. The Reagan Administration signed off on TEFRA, 280E included.

Then there are state taxes. Willy-nilly, a 280E analogue hits many state income tax returns. That’s because many of the 43 states that have income taxes just conform to federal rules automatically. Many states allow only deductions that are allowed on the federal return—so marijuana sellers get nicked again.

The impact for advertising? 280E makes marijuana ads cost more, after tax, than standard ads. That higher cost will nudge against marijuana consumption, in one of two ways. Either sellers will be dis incentivized from advertising or the additional costs will be passed onto the consumer through higher prices. So do marijuana ads, and higher consumption, create a problem? There are two sides to that
What’s wrong with marijuana advertising?

Marijuana’s political vulnerability starts with youth use. That’s where advertising comes in. Children and adolescents are uniquely susceptible to advertising. Already, kids who see medical marijuana ads are more likely to use the drug. Parents worry that kids will respond to kid-friendly ad messages or images, like “Buddie,” the smiling mascot of the losing “Responsible Ohio” legalization campaign, all too reminiscent of the shameful “Joe Camel.” Marijuana opponent Kevin Sabet warns of allowing “our teens to be bombarded with promotional messages from a new marijuana industry seeking lifelong customers.” While youth use of marijuana is reportedly plateauing, there’s a worry that over time, advertising will provide “a sexy, fun image” that will push youth use up.

Beyond parents, other legalization skeptics see advertising as a red flag. Ads will inevitably reach excessive and dependent users, who don’t need their demand stoked. Marijuana ads, like alcohol billboards, might target poor communities. Others worry Big Marijuana might use advertising as Big Tobacco and Big Alcohol did—and join the ranks of persistent enemies of public health.

To many supporters of legalization, meanwhile,
advertising is a frill. Historically, marijuana commerce operated by word of mouth, underground. Traditional growers did the opposite of advertising: They learned how to hide. Consumers did not need advertising to find what they wanted. Harm-reduction reformers, whose goals include stopping arrests, aren’t leading the charge for advertising rights. So anti-ad rules can go a long way toward mollifying skeptics—without bothering some legalizers much.

The utility of marijuana advertising

Here’s the other side of the issue. Maybe marijuana advertising is not a problem that needs solving, or even addressing. Some legalizers say ads are a natural and proper part of U.S.-style free market capitalism.

Some arguments for marijuana ads are financially motivated. Retailers use ads to make money. Entrepreneurial MBAs are bringing marketing skills to the retail side of the industry—and want to use them. The industry would like to educate tourists about “[s]hatter, wax, hash, dabs and transdermals. Our visitors, they have no idea what the modern industry has in the store for them.” The media might be tempted by the lure of ad dollars, despite the taint of association with a federally illegal drug. Indeed, as the economic risk of illegality fades, financial motivation may lurk in marijuana policy arguments, as traditional business players, like November’s failed “Responsible Ohio” cartel, push aside bold outlaw
entrepreneurs to take the lead in legalization efforts.

Other support for marijuana ads is philosophical. One argument is that marijuana use, in the aggregate, is so beneficial that society should promote it—or at least not suppress it. Another argument is that government shouldn’t have different commercial rules for different legal products. For instance, if you legalize marijuana, treat it like milk. This approach would force government to choose between two extremes—prohibition, or an all-out commercial model. If you distrust government, and want to limit its power, narrowing its options might look like a good idea. But narrowing options might backfire, and prevent any reform, if the public resists radical change.

Free Speech and 280E

It turns out that government’s power to limit advertising of legal products is, in itself, limited. Within living memory, the Supreme Court has extended the First Amendment to “commercial free speech”—like liquor billboards and TV ads. Marijuana is not federally protected yet, because it’s still federally illegal. But that could change. And there’s a pressing, immediate problem: states have their own constitutions with free speech clauses that often say they can’t ban commercial speech outright. So once a state legalizes marijuana, sellers typically have some right to advertise it—thanks to the state’s own Constitution.
Using a state constitutional amendment to legalize marijuana can end state protection for marijuana ads. Colorado’s 2012 amendment, though, wasn’t drafted clearly enough to prevent a state constitutional challenge to some ad restrictions the state is hoping to enforce.

In any event, in most state constitutions, commercial speech isn’t completely protected. Additionally, industry structure can constitutionally discourage aggressive marketing, by restrictive licensing that keeps businesses small, by limiting channels of distribution (so marijuana isn’t sold in convenience stores, for instance), or by allowing sales only in government stores.

But perhaps the most practical tool against marijuana advertising is a tax tool like 280E. Call it the joker in the deck: There is no constitutional right to a tax deduction. A legislature may not be able, constitutionally, to ban commercial speech, but nothing requires a legislature to make selling costs tax-deductible. That is, tax deductions depend on “legislative grace”—the legislative branch can grant them, or deny them. If the First Amendment protected tax deductions, lobbying expenses would be deductible, but they aren’t. In 2014, Republican Way and Means Chair Dave Camp proposed that even standard advertising should not be totally deductible up front—some costs should be “amortized,” or spread
out over time, because ads can produce long-term results.

**Beyond advertising to marketing**

The plot thickens. Even if marijuana ads were totally banned, a tax tool like 280E would come in handy.

So far, it has been easy to use “advertising” as shorthand for “marketing.” Here’s the more nuanced picture: Advertising is just part of marketing, and the real issue is marketing, or selling, writ large—promoting, branding, displaying products, studying consumer behavior, advertising, or otherwise trying to make the sale. 280E makes all those marketing expenses non-deductible—for good or for ill.

Even an outright ad ban, if it were constitutional, wouldn’t discourage the other marketing expenses that 280E disallows.

Retail space is an example. Enterprising businesspeople organize their stores with the natural aim of enticing purchasers. Look at tobacco marketing. Tobacco companies had to sign away their constitutional right to advertising—to settle legal claims about their deception campaign. So now, tobacco sellers try to lure buyers with point-of-sale (POS) “Power Wall” displays in convenience stores. **Sure enough, “Empirical studies consistently have found that exposure to POS tobacco product displays**
are associated with increased initiation among youth and reduced cessation by current smokers.” 280E, by disallowing deductions for renting retail space, and for salaries of retail clerks, takes aim at Power Walls and at all sales efforts, not just at ads.

Maybe laws can’t stop marijuana marketing, but taxes can slow it down.

While marketing feels the pinch of 280E, production doesn’t. So the impact of 280E’s tax policy is focused even within the marijuana industry. By hitting selling costs, 280E hurts primarily stores, not farms. That is, growers don’t suffer much; retailers do. That’s because “cost of goods sold” includes all of a farmer’s expenses of providing the plant (e.g., water, rent, labor, product research, testing, and electricity). That’s all deductible. And a retailer can deduct the amount it pays the grower for product. But the retailer can’t deduct selling costs—advertising, rent, payments to selling personnel, utilities—you name it. That non-deductibility hampers retailing. (Growers, too, can’t deduct advertising, salaries of sales people, or other selling expenses, but those amounts tend to be negligible—except for growers selling directly to consumers.) If it’s selling efforts that are worrisome, 280E’s aim looks pretty true.

**Tax policy objections to 280E**

To critics, 280E looks more like an awkward
workaround of the commercial free speech doctrine than a model of tax policy. Its total denial of deductions doesn’t measure income accurately. That is, a taxpayer hit by 280E pays tax on “phantom income”—that taxpayer’s taxable income is greater than its actual income, because of the deductions that 280E denies. So marijuana selling expenses are treated like bribes, kickbacks, lobbying expenses, and fines—expenses that aren’t deductible, though they are associated with efforts to produce income in a traditional business sense. And 280E encourages weird ploys—entrepreneurial creativity in the face of legal minutiae—like retailers having cashiers slowly roll joints when idle. That joint-rolling part of their work is production, not selling, so some of their hourly pay arguably goes into deductible “cost of goods sold” rather than non-deductible selling costs.

And 280E is discriminatory. Other illegal activities—prostitution, cigarette smuggling, gun-running—weren’t touched by the 1982 law, only drugs were. (To be clear, those businesses’ marketing expenses tend to be trivial, so this objection is mainly theoretical.)

There’s more. 280E is overbroad in two ways. First, it penalizes advertising that doesn’t persuade, entice, or stoke demand. Ads listing hours of operation, for instance, inform rather than persuade. Second, 280E denies deductions for expenses that have nothing to do with marketing—and discourages activity that may be not be pernicious. For instance, legal and
accounting fees are not part of “cost of goods sold,” so they are not deductible (though lawyers and accountants sometimes turn out to be giving business advice). Fine-tuning 280E to try to allow deductions for expenses that don’t directly promote sales would seek fairness—at the expense of simplicity. 280E’s broad brush may be more useful than no brush at all.

In 1982, as Bob Dole’s committee pushed 280E through, all of those objections were available but none prevented passage. Neither did the “belt-and-suspenders” argument—that the belt of criminal laws, including fines, could adequately handle drug dealers, so a tax penalty was like unnecessary suspenders. Now the criminal-law belt is disappearing (as federal prosecutorial discretion lets state-legal marijuana businesses operate), but the tax-law suspenders are still working. Opponents of marijuana have something to hold onto. And one must ask: Is Bob Dole smiling?

**Marijuana marketing and beyond—ramifications of 280E**

For marijuana, 280E remains a critical check. It pushes marijuana commerce toward a low profile that might thread the needle between opponents and enthusiasts. This is legalizing without publicizing—as proposed in another context, “Does it really matter what these affectionate people do, so long as they don’t do it on the street and frighten the horses?” Hiding marijuana use and publicity from youth would
suit a lot of parents just fine.

But marijuana, as a public health menace, pales in comparison to alcohol and tobacco. So the tax tool of deduction denial could be used against other problematic marketing efforts. The American Medical Association **opposes** direct-to-consumer advertising of prescription drugs—like the **Viagra** ads Bob Dole appeared in after his turn as Republican Presidential nominee in 1996. A middle-ground **compromise** would deny tax deductions for those ads. **280E’s** broad anti-deduction rule would even make those cigarette-selling **Power Walls** more expensive, after tax. And one **study** says denying tax deductions for alcohol ads would save 1,300 lives a year.

**Now what?**

Let’s face it: Marijuana, when it’s legal, is going to be **taxed**. Even tax opponent Grover Norquist **says** marijuana taxes won’t violate his no-tax pledge. And **280E-style** taxes discouraging advertising will be only secondary. The **main taxes** will eventually be measured by weight, price, or area under cultivation—or maybe by amount of THC, the primary intoxicant. Or hothouses’ electricity use could be taxed—to encourage outdoor growing. Or all of those taxes could be applied.

As legalization and taxation of marijuana advance, repeal or amendment of **280E** would be difficult.
(Normalizing banking rules for the marijuana industry is a no-brainer, by comparison.) As a practical matter, cutting taxes is hard in a time of deficits, particularly on a perceived vice. Repeal would be a revenue loser, and would have to be paid for—unless advocates steamroll repeal through, saying, “Deficits don’t matter.” The obvious way to pay for repeal of 280E is a federal marijuana excise tax. A federal excise tax could mean a higher tax burden overall for the industry. That result could be lose-lose: Higher taxes would hurt the industry, while repeal of 280E would encourage marijuana marketing, to the likely detriment of youth and excessive users.

And 280E has a surprising advantage over other possible federal marijuana taxes. Decades-old multilateral narcotics treaties make it awkward for the federal government to tax marijuana. Uruguay, Jamaica, Canada, and other countries may violate those treaties, but still. Any explicit new federal excise tax would look like full-blown legalization—creating a treaty problem. 280E is not part of legalization. On the contrary, Bob Dole’s tax penalty is consistent with illegality of marijuana. 280E brings in revenue but doesn’t violate treaties. What a deal.

Meanwhile, what about those state income tax 280E analogues that became state law automatically? My friends who chaired California’s Blue Ribbon Commission on marijuana legalization looked at the partial 280E analogue there, and say that denying
“regular business tax deductions . . . at the outset may be too onerous.” Indeed, it makes sense to ratchet marijuana excise taxes up over time, as the industry matures, and as pre-tax prices fall. But a 280E-type rule, nudging against advertising and marketing, may be the first tax you want to apply. As Bob Dole did.

So a 280E-style tax nudge can restrict marijuana marketing and throw sand in the gears of Big Marijuana. Meanwhile, bigger menaces, Big Alcohol and Big Tobacco, get to deduct every penny they can spend to promote sales. The commercial free speech doctrine may let sellers advertise and promote those products, but we don’t have to subsidize those sellers with tax deductions. So here’s a concluding thought: Try to extend 280E to the deadlier duo—alcohol and tobacco. Maybe give direct-to-consumer pharmaceutical ads the same treatment. But whatever you do, keep the 280E rule for marijuana marketing. If you can’t stop it, you can at least slow it down.