IN THE UNITED STATE DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No.: 1:16-cv-00258-CBS

ALPENGLOW BOTANICALS, LLC, a Colorado limited liability company,
CHARLES WILLIAMS, and
JUSTIN WILLIAMS,

Plaintiffs,

v.

UNITED STATES OF AMERICA,

Defendant.

PLAINTIFFS' RESPONSE TO UNITED STATES' MOTION TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION AND FAILURE TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED

THE PLAINTIFFS, Alpenglow Botanical, LLC, Charles Williams, and Justin Williams, by and through their undersigned counsel, respond to Defendant's Motion to Dismiss as follows:

I. Introduction

The Plaintiffs filed this action in order to seek a refund of overpaid taxes by the taxpayers. The dispute centers around certain tax deductions claimed by Plaintiffs, and disallowed by Defendant, on Plaintiffs' 2010, 2011, and 2012 tax returns. Those deductions included typical deductions from income taken by businesses for necessary operational costs incurred running the business and delivering product to customers pursuant to 26 U.S.C. §162(a). Defendant premised its disallowance of Plaintiffs' claimed deductions not on the impermissibility of the deductions themselves – the deductions were legal expenses such as rent and wages - but on its conclusion that

Plaintiffs had earned their reported income via a trade or business consisting of the illegal trafficking of controlled substances under the federal Controlled Substances Act, 18 U.S.C. § 801, *et seq*. (the "CSA"). Plaintiffs, however, have never even been accused, let alone convicted, of violating the CSA, and Defendant has exceeded its authority by surreptitiously conducting a criminal investigation into Plaintiffs' business activities that was built upon evidence Plaintiffs had been forced to provide against themselves. The result of Defendant's denial of the deductions is a tax bill for Plaintiffs that exceeds their net income. Allowing Defendant to proceed in this manner would empower it to use the tax code to enforce its unilaterally developed public policy preferences, and fatally cripple an industry that is legally operating under, and heavily regulated by, the laws of the State of Colorado.

Plaintiffs are seeking: (1) a determination that Defendant, through the Internal Revenue Service (the "IRS"), lacks the authority, either constitutionally or statutorily, to determine public policy under the CSA, to conduct criminal investigations into, and levy penalties against participants in Colorado's legalized and regulated marijuana program; (2) an injunction prohibiting the IRS from making and enforcing its public policy decisions about Colorado's marijuana program on Plaintiffs and the citizens of Colorado; and (3) a monetary award pursuant to 26 U.S.C. § 7430 and an award of reasonable costs and attorneys' fees pursuant to 28 U.S.C. § 2412 to compensate them for the tax burden improperly imposed upon them. Defendant has asked for Plaintiffs' Complaint to be dismissed based on its assertions that the requested injunctive relief is statutorily barred, and that the remainder of the complaint fails to state a claim upon which relief can be granted. Both assertions are wrong, and Defendant's Motion should be denied.

II. Standard of Review

a. Fed. R. Civ. P. 12(b)(1)

In considering a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(1), "the Court must construe the complaint broadly and liberally." *Axtell v. U.S.*, 860 F. Supp. 795, 797 (D. Wyo. 1994) (citing 5A CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FED. PRACTICE & PROCEDURE: Civil 2d §1350, at 218 (2d ed. 1990)). At the pleading stage, courts assume that specific standing allegations are subsumed under broad standing allegations. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992) (on a motion to dismiss, it is presumed that general allegations embrace those specific facts that are necessary to support the claim).

Although a defendant seeking to dismiss a complaint under Rule 12(b)(1) may challenge the facts upon which subject matter jurisdiction depends, Defendant has not done so here, instead arguing that Plaintiffs' request for injunctive relief is barred by the Anti-Injunction Act. 26 U.S.C. § 7421. Because Defendant's Motion does not challenge Plaintiffs' factual allegations, the Court must accept the allegations in the complaint as true for purposes of evaluating Defendant's Rule 12(b)(1) request. *Holt v. United States*, 46 F.3d 1000, 1003 (10^{th} Cir. 1995).

b. Fed. R. Civ. P. 12(b)(6)

Federal Rule of Civil Procedure 12(b)(6) provides that a defendant may move to dismiss a claim for "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6) (2007). "The court's function on a Rule 12(b)(6) motion is not to weigh potential evidence that the parties might present at trial, but to assess whether the plaintiff's complaint alone is legally sufficient to state a claim for which relief may be granted." *Dubbs v. Head Start, Inc.*, 336 F.3d 1194, 1201 (10th Cir. 2003) (citations and quotation marks omitted).

"A court reviewing the sufficiency of a complaint presumes all of plaintiff's factual allegations are true and construes them in the light most favorable to the plaintiff." *Hall v. Bellmon*, 935 F.2d 1106, 1198 (10th Cir. 1991). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (*citing Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). Plausibility, in the context of a motion to dismiss, means that the plaintiff has pled facts which allow "the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id*. The *Iqbal* evaluation is a two-step analysis. First, the court identifies "the allegations in the complaint that are not entitled to the assumption of truth," that is, those allegations that are legal conclusion, bare assertions, or merely conclusory. *Id*. at 679–81. Second, the Court considers the factual allegations "to determine if they plausibly suggest an entitlement to relief." *Id*. at 681. If the allegations state a plausible claim for relief, such claim survives the motion to dismiss. *Id*. at 679.

III. Background

a. Factual Background

The facts alleged by Plaintiffs in their Complaint most critical to determination of Defendant's motion are as follow. Plaintiffs conducted business in 2010, 2011, and 2012, and timely filed tax returns. Complaint ¶¶ 6-8. After auditing those returns, the

IRS disallowed certain deductions taken by Plaintiffs for lawful expenses they incurred operating their business. Complaint ¶ 9. Those deductions were disallowed based not on a criminal conviction of Plaintiffs, but on the IRS's administrative determination that Plaintiffs had generated their income by trafficking in a Schedule I controlled substance, in violation of the CSA. *Id*. The IRS did not inform Plaintiffs that it was collecting evidence of their supposed criminal activity, nor did it give them Miranda warnings about their right to not provide the IRS with incriminating information. Complaint ¶ 20. The result of the IRS's determination was a combined increase in tax liability of more than $53,000 for the individual Plaintiffs (the LLC is a "pass through" entity, and its tax liability is passed through to its individual owners). Complaint ¶ 11.

b. Political Background

The issues raised by Plaintiffs' Complaint arise against the backdrop of an evolving legal landscape concerning the distribution and consumption of marijuana, a decision pushed to the forefront by Colorado's recent legalization of the possession and sale of marijuana. As the Court is well aware, Colorado has legalized marijuana sales by licensed dispensaries for both medical and recreational purposes. The CSA arguably prohibits such sale and distribution. The law, however, is far from clear.

In December 2015, the Tenth Circuit observed "the mixed messages the federal government is sending these days about the distribution of marijuana." *Feinberg v. Commissioner*, 808 F.3d 813, 814 (10^{th} Cir. 2015). The Court further noted that the Department of Justice had made a policy of non-prosecution of state-legal marijuana sales, but that the IRS had taken a hardline approach, investigating and finding that taxpayers were violating federal drug laws by the same actions. *Id*. The Court stated that “you might be forgiven for wondering whether … any admission by the petitioners about their involvement in the marijuana trade still involves an ‘authentic danger of self-incrimination.’” *Id*. at 816. The clear import of the Court’s message was a doubt that the state-legal marijuana sales could now be considered illegal on the federal level.

Also, in December 2015, the Solicitor General submitted a brief to the U.S. Supreme Court in *Nebraska v. Colorado,* 577 U. S. ____ (2016) stating that in its opinion, Colorado’s marijuana laws and actions may not be preempted by the CSA and are a lawful exercise of its sovereign authority. See Brief attached hereto as Exhibit 1, at 22.

In just the last few months, and in just this Circuit, the inconsistencies have been noted several times:

- In an order granting dismissal in *Safe Streets Alliance v. Hickenlooper*, 1:15-cv-00349-REB-CB (Jan 19, 2016), Judge Blackburn stated: “The Department of Justice has made a conscious, reasoned decision to allow the states which have enacted laws permitting the cultivation and sale of medical and recreational marijuana to develop strong and effective regulatory and enforcement schemes.” He also noted, “Allowing private litigants to interfere with that discretionary decision would create precisely the type of ‘risk of inconsistent interpretations and misincentives which strongly counsel against recognizing an implicit right to a judicially created equitable remedy.’”
- In her order denying summary judgment of *Green Earth Wellness v. Attain Specialty Ins. Co.*, 13-cv-03452-MK-NYW (Feb. 17, 2016), Judge Krieger noted that the federal government appeared to have different “*de jure* and *de facto* public policies regarding state-regulated medical marijuana.” Given the

unclear public policy, Judge Kreiger refused to conclude that state-regulated marijuana could be considered "contraband" under a policy of insurance.

- The intersection of the CSA and Colorado's marijuana laws were again recently addressed in *Smith v. Hickenlooper*, 15-cv-00462-WYD-NYW (Feb. 26, 2016). In this case, the Plaintiffs' claims of civil RICO violations against the State of Colorado were rejected by court. In his order dismissing that case, Judge Daniel noted that enforcement of the CSA is "expressly delegated to the Attorney General of the United States, with criminal liability being the principal enforcement mechanism." *Smith v. Hickenlooper*, 15-cv-00462-WYD-NYW (Feb. 26, 2016). While there was no explicit ruling regarding IRS jurisdiction, the decision implies that there is no delegation of authority outside of the Attorney General. Thus, neither the CSA or the Tax Code gives the IRS authority to determine whether a taxpayer has violated federal drug laws.

The unclear, vague, and contradictory messages that the federal government is sending about enforcement of marijuana laws raises constitutional concerns. *See Lanzetta v. New Jersey*, 306 U.S. 451, 453 (1939) *quoting Connally v. Gen. Constr. Co.*, 269 U.S. 385, 391 (1926) ("[A] statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law.").

Against this backdrop, the IRS is conducting pseudo-criminal investigations into the source of taxpayer income to, for all intents and purposes, convict taxpayers of violating federal criminal drug laws and strangle an entire industry that has recently been legalized, regulated, and taxed by the Colorado state legislature. *Feinberg, supra*. The IRS, however, has no authority to run criminal investigations or render criminal verdicts of illegal acts outside of the Tax Code. Defendant is hoping to prevent the Court from making this point explicit. Its effort should be denied, and this case allowed to proceed.

IV. Argument

a. The IRS does not have authority to investigate or rule upon whether activity violates a criminal statute outside of the Tax Code.

Defendant takes the position that, in disallowing Plaintiffs' deductions, it was simply enforcing a civil provision of the Internal Revenue Code (the "Tax Code"), and not conducting a criminal investigation into Plaintiffs' business activities (a tacit acknowledgement that conducting such an investigation would exceed its authority). Defendant even acknowledged: "plaintiffs are correct that the IRS does not have the authority to enforce the CSA." Defendant's Motion to Dismiss, p. 5 [Doc. 11]. Despite Defendant's protestations, Section 280E requires there to be a finding of illegality under federal drug laws before it can be applied. No finding of illegal behavior by Plaintiffs has ever occurred outside of the IRS's summary determination.

In its Motion, Defendant included only a portion of the Code section at issue. The full section reads as follows:

> 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**.[1]

26 U.S.C. § 280E ("Section 280E") (emphasis added).

The plain language of Section 280E makes it clear that the "trafficking" of controlled substances must be illegal for Section 280E to apply. The 1982 Senate Report on the Tax Equity and Fiscal Responsibility Act (attached hereto as Exhibit 2), in which the reason for the enactment of Section 280E was discussed, leads to the same conclusion: "All deductions and credits for amount paid or incurred in the ***illegal*** trafficking in drugs listed in the Controlled Substances Act are disallowed." *Report of the Committee on Finance United States Senate on H.R. 4961*, p. 309 (emphasis added). The IRS even conceded this point in the *Feinberg v. Commissioner* matter. Attached as Exhibit 3 is a portion of a brief filed by the IRS in that matter in the trial court, which states: "[A]pplication of section 280E requires the predicate determination that [the taxpayer] trafficked in a controlled substance, an act that constitutes a federal crime under the relevant statutes…" *IRS Response to Petitioners' Motion for Summary Judgment*, p. 9. In other words, Defendant is not denying that a finding of illegality needs to occur before Section 280E can be applied to disallow deductions, but is taking the incorrect, and deeply concerning, position that the IRS can unilaterally make that determination without court involvement or oversight.[2]

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[1] Colorado legalized the sale and distribution of marijuana by state-licensed dispensaries when it ratified constitutional amendments 20 and 64. Thus the question of whether Colorado prohibits the transactions is not relevant to Section 280E inquiry as such sales are now lawful.

[2] Summary actions by auditors making findings of criminality would probably not comport with the due process clause. *Lipke v. Lederer*, 259 U.S. 557, 562 (1922) ("And certainly we cannot conclude, in the absence of language admitting of no other construction, that Congress intended that penalties for crime should be enforced through the secret findings and summary action of executive officers. The guarantees of due process of law and trial by jury are not to be forgotten or disregarded.")

Additionally , the CSA defines a “drug trafficker” as one who has been convicted of the distribution of a controlled substance. See 21 U.S.C. 862(a); *see also United States v. Williams*, 541 F.3d 1087 (8th Cir. 2008) (21 U.S.C.S. § 862 defines trafficking offenses as consisting of the distribution of controlled substances). The CSA itself does not lend to the IRS's position of illegality.[3]

Not requiring a finding of illegality before allowing the IRS to apply Section 280E would have unintended consequences. If both legal and illegal “trafficking” of Section I and II controlled substances were subject to Section 280E, all the manufacturers, sellers, and distributors of Schedule II controlled substances would fall under its provisions. Schedule II controlled substances include such popular drugs as Vicodin, Demerol, OxyContin, Adderall, and Ritalin. *See* http://www.dea.gov/druginfo/ds.shtml (last visited May 5, 2016). If the legal sale of such drugs falls under Section 280E, the entire pharmaceutical industry, as well as retailers with pharmacies, such as Walgreens, Wal-Mart, and Kroger stores will find their business deductions taken away. This is not how the IRS has previously interpreted Section 280E. A general review by the undersigned of the Lexis court service did not reveal a single instance of the IRS applying Section 280E to Schedule II transactions, although perhaps it means to start.

The IRS has been long aware that it does not have the power to make determinations of illegality outside of the Tax Code. General Counsel for the IRS has stated:

> “The Internal Revenue Service is not in a position to make determinations as to the illegality of an act under a provision of law other than the Internal

[3] The court should not give the Defendant deference to its interpretation of Section 280E. The IRS has issued no regulations or any other interpretative documents which would allow the court to give deference to its interpretation. The positions by the IRS as simply litigating positions which provide no deference at all. *JT USA v. IRS,* 771 F.3d 654, 660 (9th Cir. 2014)(Litigating position by IRS is not entitled to *Chevron* deference).

> Revenue Code. The Constitution of the United States provides for separation of powers, and a determination of illegality in such cases is within the province of the judiciary. From an administrative standpoint alone, such a task would be impossible for the Internal Revenue Service to undertake. From a legal standpoint, moreover, the onus which attaches to a determination of illegality is such that it would be improper to delegate such a determination to an administrative body without the procedural and substantive due process protection provided through the judicial process."

GCM 37111 at 11.

Given the above, the IRS does not have the authority to determine whether taxpayers have violated federal drug laws.

b. The IRS's Surreptitious Criminal Investigation of Plaintiffs' Business Activity Forced Them to Provide Criminal Evidence Against Themselves, in Violation of the Fifth Amendment

In response to Plaintiff's allegation that the IRS illegally "took evidence from Plaintiffs in an effort to establish that the [Plaintiffs] committed a federal crime without informing the Plaintiff that they were under investigation for violation of the CSA" (Complaint ¶ 20), Defendant claims that the IRS did not gather evidence to determine whether Plaintiffs had committed a crime, but instead to determine their correct tax liability under Section 280E. As explained above, however, the determination that Plaintiffs had committed a crime had to have occurred before the IRS would have been authorized to apply Section 280E. The IRS could not have concluded that Section 280E applied without first determining that Plaintiffs had illegally trafficked schedule I or II drugs in violation of the CSA, something that is not within its authority to do.

Defendant also argues that Fifth Amendment protections are not applicable here because the Fifth Amendment only applies to "compelled testimonial communications," and the compulsion of testimony did not occur here. It is, however, well established that the Fifth Amendment can be asserted in response to information required by the IRS, if that information may reveal criminal activity. In *Garner v. U.S.*, for example, the Supreme Court concluded that the admission of tax returns at a defendant's criminal trial did not violate his Fifth Amendment right to avoid self-incrimination because the defendant could have invoked the Fifth Amendment on the admitted tax return. 424 U.S. 648, 656 (1976); *see also U.S. v. Sullivan*, 274 U.S. 259, 263 (1927) ("If the form of return provided called for answers that that the defendant was privileged from making he could have raised the objection in the return, …"). In the case cited by Plaintiffs in their Complaint, the court held that the failure by the IRS to reveal the criminal nature of inquiries being made to the taxpayer was improper and should result in the suppression of evidence gathered as a result. *U.S. v. Tweel*, 550 F.2d 297 (5^{th} Cir. 1977).

Defendant compelled the production of the information under color of its civil audit authority. The IRS could not have conducted its improper criminal investigation into Plaintiffs' business activity without the information it required Plaintiffs to produce. The IRS should, therefore, have given Plaintiffs notice that the information it was requiring them to provide was being used to develop findings of criminal wrongdoing against them. Had an actual criminal trial been held, the evidence gleaned from this kind of secret investigation would have been suppressed. The IRS should not be allowed to avoid that result by circumventing the court system with its own, in-house justice system.

c. The IRS's Calculation of Plaintiffs' Income Violates the Sixteenth Amendment

The IRS derives its power to tax income from the Sixteenth Amendment to the United States Constitution, which reads as follows: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." Congress, however, may not impose any definition of income that it desires. To say that Congress is authorized to "collect taxes on incomes" does not settle the matter as to what constitutes taxable income. It is not every dollar that comes in through a business's doors, but is instead limited to "'[t]he *gain* derived from capital, from labor, or from both combined,' provided it be understood to include profits gained through sale or conversion of capital assets." *Goodrich v. Edwards*, 255 U.S. 527, 535 (1921), *citing Eisner v. Macomber*, 252 U.S. 189, 207 (1920) (emphasis in original). Taxable income is the income that remains after "certain necessary items like property sold; ordinary and necessary expenses incurred in getting the so-called gross income; depreciation, depletion, and the like" have been removed from the gross income. *Davis v. U.S.*, 87 F.2d 323, 324 (2nd Cir. 1937). Although these "certain necessary items" may be referred to as "deductions," they are distinguishable and separate from the types of deductions that "may be allowed or not in the sound discretion of Congress." *Id*. at 325.

To allow the IRS to prevent the deduction of expenses that a business could not avoid incurring in order to collect the income received would result in an arbitrary number, disconnected from the actual performance of the business, and would enable the IRS to do as it is trying to do here and enforce its policy preferences by levying a tax against disfavored businesses that exceeds the amount of income they actually earned.

d. Plaintiffs' Claims Are Not Barred by the Anti-Injunction Act because the Anti-Injunction Act is Inapplicable Here.

i. The behavior that Plaintiffs seek to enjoin is not the assessment or collection of taxes.

Defendant asserts that Plaintiffs' request for injunctive relief is barred by the Anti-Injunction Act because none of the exceptions to that Act apply, but has skipped right past whether the Anti-Injunction Act applies in the first place. It does not.

The Anti-Injunction Act states: "No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person…" 16 U.S.C. § 7421(a). In order for the Anti-Injunction Act to apply, Defendant must show that the claimant seeks to restrain the "assessment" or "collection" of tax. *Direct Mktg. Ass'n v. Brohl*, ___ U.S. ___, 135 S.Ct. 1124, 1129 (2015).[4] These terms are all narrowly defined and inapplicable to the relief Plaintiffs are requesting here.

"'Assessment' … refers to the official recording of a taxpayer's liability, which occurs after information relevant to the calculation of that liability is reported to the taxing authority." *Id*. at 1130. In *Direct Mktg. Ass'n*, the Court rejected a broader interpretation, under which the process by which the amount is calculated would also be exempt from injunction, stating that "'assessment' has long been treated in the Tax Code as an official action taken based on information already reported to the taxing authority." *Id*.

"'Collection' is the act of obtaining payment of taxes due." *Id*. It is "part of the enforcement process that 'assessment' sets in motion." *Id*.

Finally, the word "restraining" in the Anti-Injunction Act also has a narrow meaning:

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[4] In *Direct Marketing Ass'n*, the Court was construing the related federal Tax Injunction Act. The analysis by the Court, however, applies equally to the Anti-Injunction Act. "We assume that words used in both Acts are generally used in the same way, and we discern the meaning of the terms in the AIA by reference to the broader Tax Code." *Direct Marketing Ass'n*, 135 S.Ct. at 1129.

> "Restrain" acts on a carefully selected list of technical terms – "assessment, … collection" – not on an all-encompassing term, like "taxation." To give "restrain" a broad meaning selected by the Court of Appeals would be to defeat the precision of that list, as virtually any court action related to any such phrase of taxation might be said to "hold back" "collection." Such a broad construction would thus render "assessment [and] levy" – not to mention "enjoining and upend" – mere surplusage, a result we try to avoid.
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> * * *
>
> Applying the correct definition, a suit cannot be understood to "restrain" the "assessment … or collection" of a tax … tax if it merely inhibits those activities.

Id. at 1132.

The activity that Plaintiffs' seek to restrain is neither the assessment nor collection of a tax, but rather the information-gathering process that the IRS used to determine that Plaintiffs had violated federal criminal drug laws, which process falls outside of the IRS's jurisdiction and authorized activity.[5] This attempt to stop the IRS's unauthorized quasi-criminal investigation of the taxpayer's purported violation of federal criminal drug laws does not fall under, and is not prohibited by, the Anti-Injunction Act.

ii. Section 280E is penal in character, and is thus not covered by the Anti-Injunction Act.

The Anti-Injunction Act is also inapplicable to this matter because it does not apply to penal statutes, such as Section 280E. *Lipke v. Lederer*, 259 U.S. 557, 561-62 (1922).

[5] In a reply filed by Defendant in another case similar to this one, Defendant argued that, in fact, the Anti-Injunction Act does apply not only to the assessment and collection of tax, but "to activities leading up to, and culminating in, such assessment and collection," and therefore, prohibits the injunction of criminal investigations beyond the authority of the IRS. See *Lowrie v. U.S.*, 824 F.2d 827 (10th Cir. 1987) (citations omitted). The behavior that plaintiff sought to enjoin in *Lowrie*, however, was the review of documents that may have evidenced "skimming," which would directly bear upon the amount of income claimed by, and resulting tax due from plaintiff. Unlike here, the IRS was well equipped to handle tax fraud matters. Here, the IRS seeks to go outside of its jurisdiction and determine whether the taxpayer is violating federal drug laws. Defendant's theory about what constitutes "collection" and "assessment" is so broad that the result would be that no activity conducted by the IRS could be enjoined, no matter how far afield from its normal collection and assessment duties, as long as it could tangentially be tied to a tax assessment. This goes much too far. Also, it should be noted that *Direct Marketing, supra.,* overturned an appellate decision out of the Tenth Circuit applying the same standard as *Lowrie*. It is clear that *Direct Marketing* has superseded *Lowrie.*

Since Section 280E only applies if the taxpayer has committed the predicate act of illegal trafficking of Schedule I or II drugs, it is a penalty, even if Congress has characterized it as a tax. *Id.*; *Feinberg, supra*. The Senate Report on the Tax Equity and Fiscal Responsibility Act of 1982 (Exhibit 2), in which the reason for the enactment of Section 280E was discussed, conclusively removes any doubt about this:

> There is a sharply defined public policy against drug dealing. To allow drug dealers the benefit of business expense deductions at the same time that the U.S. and its citizens are losing billions of dollars per year to such persons is not compelled by the fact that such deductions are allowed to other, legal, enterprises. Such deductions must be disallowed on public policy grounds.

Senate Report, *supra* at 309.

Since Section 280E is penal in nature, the Anti-Injunction Act does not apply, and a court of equity can enjoin the assessment and collection of such a penalty. *Robertson v. United States*, 582 F.2d 1126 (7th Cir. 1978) (finding that the Anti-Injunction Act does not apply to actions enjoining assessment under the Marijuana Tax Act). See also, *Chamber of Commerce of the United States v. Edmondson*, 594 F.3d 742, 763-64 (10th Cir. 2010)(A penalty, regardless of how it is designated by the state, is not a tax for purposes of the Tax Injunction Act).

e. The Penalty Assessed Against Plaintiffs is Excessive and Violates the Eighth Amendment

The tax liability assessed against Plaintiffs as a result of the application of Section 280E will deal a fatal blow to their business (and industry) if allowed to stand because the amount of the tax exceeds their net income. This extreme result would violate the Eighth Amendment’s prohibition of “excessive fines.” Defendant argues that the Eighth Amendment is inapplicable because the IRS is only enforcing a tax provision, and not a penalty, as supposedly evidenced by its location in a section of the Internal Revenue

Code separate from where penalties are contained. The label ("tax" vs. "penalty") attached to a statutorily-required payment by Congress, however, does not determine whether the payment is a penalty or tax for purposes of assessing the payment's constitutionality. *Nat'l Fed'n of Indep. Bus. v. Sebelius*, ___ U.S. ___, 132 S.Ct. 2566, 2583 (2012). "Congress may not, for example, expand its power under the Taxing Clause, or escape the Double Jeopardy Clause's constraint on criminal sanctions, by labeling a severe financial punishment a 'tax.'" *Id*. *citing Bailey v. Drexel Furniture Co.*, 259 U.S. 20, 36-37 (1922).

There is not a clear line dividing taxes from penalties, but once the underlying motive of a required payment appears to cross over from collecting revenue to discouraging certain activity, the required payment is more fairly characterized as a penalty than a tax, even if characterized by Congress as a tax:

> The difference between a tax and a penalty is sometimes difficult to define, and yet the consequences of the distinction in the required method of their collection often are important. Where the sovereign enacting the law has power to impose both tax and penalty, the difference between revenue production and mere regulation may be immaterial, but not so when one sovereign can impose a tax only, and the power of regulation rests in another. Taxes are occasionally imposed in the discretion of the legislature on proper subjects with the primary motive of obtaining revenue from them and with the incidental motive of discouraging them by making their continuance onerous. They do not lose their character as taxes because of the incidental motive. But there comes a time in the extension of the penalizing features of the so-called tax when it loses its character as such and becomes a mere penalty with the characteristics of regulation and punishment.

Bailey, 259 U.S. at 38.

As noted above, the size of the tax due as a result of the IRS's imposition of Section 280E exceeds the net income earned by Plaintiffs and would make it impossible for them to continue their business. In other words, the required payment would not only discourage Plaintiffs' state-authorized business activities, but would render them entirely impossible to carry on. Although the IRS's actions result in the collection of revenue, this will be short-lived, as this policy, if allowed to continue, will quickly stamp out all of Colorado's legalized marijuana industry. This regulatory effect converts this charge from a tax into a penalty, and subjects it to Eighth Amendment limitations on "excessive fines," a limitation it clearly exceeds with its punitive, industry-ending effect.

V. Conclusion

For the foregoing reasons, Plaintiffs ask the court to ***deny*** Defendant's Motion.

Respectfully submitted this 10th day of May, 2016.

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CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of May, 2016, I electronically filed the above and foregoing using the CM/ECF system, which will send notification of such filing to the following party at the e-mail address listed below:

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