894 F.3d 1187

United States Court of Appeals for the Tenth Circuit

July 3, 2018, Filed

No. 17-1223

ALPENGLOW BOTANICALS, LLC, a Colorado Limited Liability Company; CHARLES WILLIAMS; JUSTIN WILLIAMS, Plaintiffs - Appellants, v. UNITED STATES OF AMERICA, Defendant - Appellee.

Counsel: James D. Thorburn (Richard Walker with him on the briefs), Thorburn Walker LLC, Greenwood Village, Colorado, for Plaintiffs - Appellants.

Patrick J. Urda, Attorney, Tax Division (Gilbert S. Rothenberg and Michael J. Haungs, Attorneys, Tax Division, and Counsel Robert C. Troyer, United States Attorney, with him on the brief), Department of Justice, Washington, D.C., for Defendant - Appellee.

Judges: Before HARTZ, MURPHY, and McHUGH, Circuit Judges.

Opinion by: McHUGH

Opinion

McHUGH, Circuit Judge.

Alpenglow Botanicals, LLC ("Alpenglow") sued the Internal Revenue Service ("IRS") for a tax refund, alleging the IRS exceeded its statutory and constitutional authority by denying Alpenglow's business tax deductions under 26 U.S.C. § 280E. The district court

dismissed Alpenglow's suit under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief could be granted, and denied Alpenglow's subsequent motion under Federal Rule of Civil Procedure 59(e) to reconsider the judgment. Exercising jurisdiction under 28 U.S.C. § 1291, we affirm.

I. BACKGROUND

Although twenty-eight states and Washington, D.C. have legalized medical or recreational marijuana use, the federal government classifies marijuana as a "controlled substance" under schedule I of the Controlled Substances Act ("CSA"). *Green Sol. Retail, Inc. v. United States,* 855 F.3d 1111, 1113 (10th Cir. 2017); *see* 21 U.S.C. § 812(c), Schedule I(c)(10); 21 C.F.R. § 1308.11(d)(23). The CSA makes it unlawful to knowingly or intentionally "manufacture, distribute, or dispense . . . a controlled substance." 21 U.S.C. § 841(a)(1). Under former President Obama, the Justice Department had declined to enforce § 841(a)(1) against marijuana businesses acting in accordance with state law,[1] but the IRS has shown no similar inclination to "overlook federal marijuana distribution crimes." *Feinberg*

[1] This policy encouraging federal prosecutors not to prosecute these cases was implemented through memoranda of the prior Attorneys General. *See*, *e.g.*, Memorandum from David W. Ogden, Deputy Att'y Gen., U.S. Dep't of Justice for Selected U.S. Att'ys (Oct. 19, 2009), *revised by* Memorandum from James M. Cole, Deputy Att'y Gen., U.S. Dep't of Justice for all U.S. Att'ys (Aug. 29, 2013). The current Attorney General has since rescinded this policy. Memorandum from Jefferson B. Sessions, Att'y Gen., U.S. Dep't of Justice for all U.S. Att'ys (Jan. 4, 2018).

v. Comm'r, 808 F.3d 813, 814 (10th Cir. 2015). Instead, the IRS consistently denies business deductions to state-sanctioned marijuana dispensaries under 26 U.S.C. § 280E,[2] which prohibits any "deduction or credit" for any business that "consists of trafficking in controlled substances (within the meaning of . . . the Controlled Substances Act)." *E.g.*, *id.*; *Olive v. Comm'r*, 792 F.3d 1146, 1147 (9th Cir. 2015).

This appeal is the product of the clash between these state and federal policies. Alpenglow is a medical marijuana business owned and operated by Charles Williams and Justin Williams, doing business legally in Colorado. *See Alpenglow Botanicals, LLC v. United States (Alpenglow I)*, No. 16-cv-00258-RM-CBS, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *2 (D. Colo. 2016) (unpublished). After an audit of Alpenglow's 2010, 2011, and 2012 tax returns, however, the IRS issued a *Notice of Deficiency* concluding that Alpenglow had "committed the crime of trafficking in a controlled substance in violation of the CSA" and denying a variety of Alpenglow's claimed business deductions under § 280E. *Id.* Alpenglow's income and

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[2] 26 U.S.C. § 280E states in full:

> 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.

resultant tax liability were increased based on the denial of these deductions. Because Alpenglow is a "pass through" entity, the increased tax liability was passed on to Charles Williams and Justin Williams. As a result, Charles Williams owed the IRS an additional $24,133 in taxes and Justin Williams owed an additional $28,961. The two men paid the increased tax liability under protest and filed for a refund, which the IRS denied. *Id.*

The men then filed a complaint in the United States District Court for the District of Colorado seeking to overturn the IRS's decision. 2016 U.S. Dist. LEXIS 183041, [WL] at *1. The United States filed a Motion to Dismiss the Complaint under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted ("Motion to Dismiss"). In its Motion to Dismiss, the United States identified four claims raised by Alpenglow, three of which are relevant to this appeal: (1) the IRS does not have the authority to disallow deductions under 26 U.S.C. § 280E without a criminal conviction; (2) § 280E violates the Sixteenth Amendment's definition of gross income; and (3) § 280E is an excessive fine that violates the *Eighth Amendment*.[3]

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[3] The Motion to Dismiss also asserted that the district court did not have subject matter jurisdiction to issue the injunctive relief requested by Alpenglow in the complaint. *Alpenglow Botanicals, LLC v. United States (Alpenglow I)*, No. 16-cv-00258-RM-CBS, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *1 (D. Colo. 2016) (unpublished). The district court denied Alpenglow's request for injunctive relief without addressing the subject matter jurisdiction argument, 2016 U.S. Dist. LEXIS 183041, [WL] at

Following oral argument on the Motion to Dismiss, Alpenglow filed a Motion to Amend the Complaint "to allege further detail as to the specific deductions that the IRS denied." *Id.* The Amended Complaint alleged "the deductions denied were: rent for where the business was conducted; costs of labor; compensation of officers; advertising; taxes and licenses for doing business; depreciation; and other wages and salaries." 2016 U.S. Dist. LEXIS 183041, [WL] at *2. Alpenglow also filed a Motion for Partial Summary Judgment Refund Claim ("Motion for Partial Summary Judgment"). In addition to the claims identified in the Motion to Dismiss, Alpenglow's Motion for Partial Summary Judgment asserted two new claims: (1) the IRS's decision to apply § 280E was arbitrary because it had no evidence Alpenglow trafficked in a controlled substance; and (2) the IRS incorrectly disallowed exclusions for Alpenglow's costs of goods sold under 26 U.S.C. § 263A.[4] In its December 1, 2016 Opinion and Order, the district court granted Alpenglow's Motion to Amend the Complaint, granted the United States' Motion to Dismiss, and denied Alpenglow's Motion for

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*6 n.3, and Alpenglow does not challenge this ruling on appeal. Thus, the jurisdictional issue, which was limited to the injunction claim, is not before us.

[4] In the Amended Complaint and Motion for Partial Summary Judgment briefing, Alpenglow also raised a ***Fifth Amendment*** claim, "alleg[ing] that the IRS should have informed plaintiffs that they were under investigation for violating the CSA." *Alpenglow I*, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *6. The district court denied this claim, *id.*, and Alpenglow does not raise it on appeal.

Partial Summary Judgment ("Rule 12(b)(6) Dismissal").[5] 2016 U.S. Dist. LEXIS 183041, [WL] at *8.

Twenty-eight days after the entry of final judgment, Alpenglow filed a Motion to Alter or Amend the Judgment pursuant to Federal Rule of Civil Procedure 59(e) ("Rule 59(e) Motion"). *Alpenglow Botanicals, LLC v. United States (Alpenglow II),* No. 16-cv-00258-RM-CBS, 2017 U.S. Dist. LEXIS 65249, 2017 WL 1545659, at *1 (D. Colo. 2017) (unpublished). The motion contained a proposed Second Amended Complaint and asserted that the district court "misapprehended controlling law" by failing to consider the three new claims Alpenglow raised as a request to amend the complaint—specifically, that (1) the IRS improperly disallowed costs of goods sold; (2) the IRS produced no evidence of trafficking; and (3) § 280E violates the *Eighth Amendment*. *Id.* Alpenglow argued the district court should grant leave to amend because the United States would not be prejudiced by allowing Alpenglow to file the Second Amended Complaint. *Id.* The district court denied the motion, concluding it was not required to consider arguments not alleged in the Amended Complaint and Alpenglow was not entitled to amend

[5] Alpenglow also filed a Motion for Order to Certify Question of Constitutionality of Colorado's Medical Marijuana Laws to Colorado State Attorney General Pursuant to 28 U.S.C. § 2403(b). *Alpenglow I*, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *1. The district court denied this motion, 2016 U.S. Dist. LEXIS 183041, [WL] at *8, and Alpenglow does not challenge that ruling on appeal.

because the request was untimely. 2017 U.S. Dist. LEXIS 65249, [WL] at *1-3.

Alpenglow appeals both the Rule 12(b)(6) Dismissal and the court's denial of its Rule 59(e) Motion. We address each order in turn, beginning with the Rule 12(b)(6) Dismissal.

II. DISCUSSION

A. Federal Rule of Civil Procedure 12(b)(6) Dismissal

"We review a district court's dismissal under Federal Rule of Civil Procedure 12(b)(6) de novo." *Khalik v. United Air Lines*, 671 F.3d 1188, 1190 (10th Cir. 2012). "Under Federal Rule of Civil Procedure 8(a)(2), a pleading must contain 'a short and plain statement of the claim showing that the pleader is entitled to relief.'" *Id.* While "the pleading standard Rule 8 announces does not require 'detailed factual allegations,'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007)), the "complaint must contain enough allegations of fact, taken as true, 'to state a claim to relief that is plausible on its face,'" *Khalik*, 671 F.3d at 1190 (quoting *Twombly*, 550 U.S. at 570). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678.

Under the *Twombly/Iqbal* pleading standard, courts take a two-prong approach to evaluating the sufficiency of a complaint. *Iqbal*, 556 U.S. at 678-79. The first prong of the test requires the court to identify which pleadings "are not entitled to the assumption of truth." *Id*. at 679. This includes "legal conclusions" as well as "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements." *Id.* at 678. The second prong of the test requires the court to "assume th[e] veracity" of the well-pleaded factual allegations "and then determine whether they plausibly give rise to an entitlement to relief." *Id.* at 679. "Accordingly, in examining a complaint under Rule 12(b)(6), we will disregard conclusory statements and look only to whether the remaining, factual allegations plausibly suggest the defendant is liable." *Khalik*, 671 F.3d at 1191.

Alpenglow argues it raised three legal theories that plausibly stated a claim and therefore precluded the district court's dismissal of the Amended Complaint under Rule 12(b)(6). First, Alpenglow asserts the IRS lacks the general authority to investigate and deny tax deductions under § 280E without a criminal conviction, and that, even if it had such authority, the IRS has insufficient evidence of trafficking to apply § 280E in this case. Second, Alpenglow claims the IRS's calculation of Alpenglow's income violates the Sixteenth Amendment. Third, Alpenglow contends § 280E violates the *Eighth Amendment*.[6] We now explain why

[6] Although the district court based its dismissal of these claims on the United States' Motion to Dismiss, it also denied

none of these arguments supports a conclusion that the district court erred in dismissing the complaint, beginning with the IRS's application of § 280E.

1. Denial of Deductions Under 26 U.S.C. § 280E

As indicated, Alpenglow raises two arguments relating to the IRS's denial of its business deductions under § 280E: the IRS (1) lacks the authority to investigate whether Alpenglow trafficked in controlled substances because such a determination requires the IRS to conclude that the business violated federal drug laws and (2) acted in an arbitrary manner because it did not have any evidence that Alpenglow trafficked in controlled substances.

a. Authority to investigate

Alpenglow claims the IRS could not use § 280E to deny the deductions in the absence of a conviction from a criminal court that its owners had violated federal drug trafficking laws. At the core of Alpenglow's argument is the assumption that a determination a person trafficked in controlled substances under *tax* law is essentially the same as a determination the person trafficked in controlled substances under *criminal* law.

Alpenglow's Motion for Partial Summary Judgment under Federal Rule of Civil Procedure 56 "with respect to whether the IRS improperly denied the cost of goods sold, whether the IRS has authority to apply § 280E, and whether the application of § 280E violates the Sixteenth Amendment." *Alpenglow I*, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *7.

Because Alpenglow sees the two as inextricably linked, it contends the IRS lacks the authority to apply § 280E until *after* a federal prosecutor has investigated and charged the taxpayer with violating federal criminal law and a judge or jury in a criminal proceeding has issued a verdict of guilty.

We recently rejected this argument in *Green Solution*, 855 F.3d at 1120-21. There, Green Solution sued to enjoin the IRS from investigating Green Solution's business records in connection with an audit focused on whether certain business expenses should be denied under § 280E. We concluded the Anti-Injunction Act ("AIA") prevented the court from exercising jurisdiction over Green Solution's "suit for the purpose of restraining the assessment or collection of any tax." *Id.* at 1119 (quoting 26 U.S.C. § 7421(a)). In an attempt to avoid that conclusion, Green Solution argued the AIA did not preclude the action because a determination of "whether [it] trafficked in a controlled substance . . . is a criminal investigation properly carried out by the United States Attorney," *id.* at 1120, and thus "a determination of whether a taxpayer violated the CSA is not within the authority of the IRS," *id.* at 1121 (internal quotation marks omitted). In rejecting this argument, we noted that "§ 280E has no requirement that the Department of Justice conduct a criminal investigation or obtain a conviction before § 280E applies." *Id.* at 1121. And we noted that under 26 U.S.C. § 6201(a), "the IRS's obligation to determine whether and when to deny deductions under § 280E[] falls squarely within its authority under the Tax Code." *Id.* But because our

analysis was limited to determining that the AIA precluded Green Solution's suit, we lacked subject matter jurisdiction to address the merits of the claim that "the IRS exceeded its authority under the Internal Revenue Code." *Id.* at 1121 & n.8. Instead, we decided "only that the IRS's efforts to assess taxes based on the application of § 280E fall within the scope of the AIA." *Id.* at 1121 n.8.

Although not directly on point, our analysis in *Green Solution* is persuasive. Alpenglow offers no reason why we should conclude the IRS has the authority to *assess* taxes under § 280E, but cannot *impose* excess tax liability under § 280E. There is also no evidence that Congress intended to limit the IRS's investigatory power. Indeed, the Tax Code contains other instances where the applicability of deductions or tax liability turns on whether illegal conduct has occurred. *See* 26 U.S.C. § 162(c)(2) (denying deductions for illegal bribes, kickbacks, etc.); *id.* § 6663 (imposing civil tax penalty for fraud); *id.* § 165(e) (allowing deduction for theft loss). And other courts have upheld tax deficiencies against state-sanctioned marijuana dispensaries based on application of § 280E, without questioning the IRS's authority on this issue. *See Olive*, 792 F.3d at 1151; *Beck v. Comm'r*, T.C. Memo 2015-149, 110 T.C.M. (CCH) 141, *5-6 (2015); *Canna Care, Inc. v. Comm'r*, T.C. Memo 2015-206, 110 T.C.M. (CCH) 408, *3-4 (2015), *aff'd*, 694 F. App'x 570 (9th Cir. 2017); *Californians Helping to Alleviate Med. Problems, Inc. v. Comm'r (C.H.A.M.P.)*, 128 T.C. 173, 181-82 (2007).

Nonetheless, Alpenglow argues that because Congress has not expressly delegated the IRS authority to investigate violations of federal drug laws, the IRS cannot make the predicate finding necessary for a denial of deductions under § 280E. In support of this proposition, Alpenglow points to a series of cases from the Supreme Court striking regulations involving the taxation of illegal conduct: *Leary v. United States*, 395 U.S. 6, 89 S. Ct. 1532, 23 L. Ed. 2d 57 (1969); *Grosso v. United States*, 390 U.S. 62, 88 S. Ct. 709, 19 L. Ed. 2d 906, 1968-1 C.B. 496 (1968); *Haynes v. United States*, 390 U.S. 85, 88 S. Ct. 722, 19 L. Ed. 2d 923, 1968-1 C.B. 615 (1968); and *Marchetti v. United States*, 390 U.S. 39, 88 S. Ct. 697, 19 L. Ed. 2d 889, 1968-1 C.B. 500 (1968). But these cases concern the invocation of the privilege against self-incrimination where the IRS investigation involved gambling, marijuana, or, in *Haynes*, possession of an unregistered firearm. *See Leary*, 395 U.S. at 13. Critically, these cases struck down IRS regulations that required the taxpayers to disclose information such as the names and addresses of the sellers and buyers, their registration numbers, and the quantity of the products sold. *See id.* at 15; *see also Marchetti*, 390 U.S. at 42-49. The Supreme Court concluded these tax provisions violated the *Fifth Amendment* due to the "substantial and 'real' . . . hazards of incrimination." *Marchetti*, 390 U.S. at 53 (quoting *Rogers v. United States*, 340 U.S. 367, 374, 71 S. Ct. 438, 95 L. Ed. 344 (1951)); *Leary*, 395 U.S. at 15. For example, in *Marchetti*, the Court noted that the regulation in question required the taxpayer to obtain a tax stamp, which necessarily "declar[ed] . . . a present intent" to violate

gambling laws, and that federal and state courts had consistently relied on payment of the tax in subsequent criminal cases against the taxpayer. *Marchetti*, 390 U.S. at 47-48, 53. Indeed, some states and municipalities criminalized the mere possession of a tax stamp, making it impossible to comply with both laws. *Id.* at 48 n.10.

Alpenglow's case is easily distinguishable from these cases. First, Alpenglow has not raised a *Fifth Amendment c*hallenge on appeal and is instead citing these cases for the IRS's *authority* to tax based on its conclusion that the taxpayer is engaged in illegal conduct. But the Supreme Court has repeatedly asserted, including in the cited opinions, that "the unlawfulness of an activity does not prevent its taxation." *Id.* at 44. The cases cited by Alpenglow were challenges to "the *methods* employed by Congress" in enforcing these statutes, *id.* (emphasis added), not the *authority* of the IRS to investigate and tax illegal activity. Second, these statutes involved the *imposition* of a *tax* for specific illegal conduct, not the *denial* of a tax *deduction*. Third, the tax information at issue in the cited cases was routinely shared with the Department of Justice and frequently used to support criminal charges, creating a tax provision that served as a proxy for a criminal investigation. Here, Alpenglow has failed to cite a single case in which the government relied on a denial of deductions under § 280E as evidence of guilt in a criminal trial. Accordingly, these decisions do not prohibit the IRS from applying § 280E to deny Alpenglow's deductions.

In summary, it is within the IRS's statutory authority to determine, as a matter of civil tax law, whether taxpayers have trafficked in controlled substances. Thus, the IRS did not exceed its authority in denying Alpenglow's business deductions under § 280E.

b. Evidence of trafficking[7]

Alpenglow also contends the IRS's denial of its deductions was arbitrary because the IRS had no proof Alpenglow trafficked in a controlled substance. But in an action to recover taxes paid to the IRS, the "taxpayer has the burden to show not merely that the IRS's assessment was erroneous, but also the amount of the refund to which the taxpayer is entitled." *Dye v. United States*, 121 F.3d 1399, 1408 (10th Cir. 1997). Under this rule, the burden falls on Alpenglow to show error, not on the IRS to prove trafficking. *See Green Sol.*, 855 F.3d at 1121; *Feinberg*, 808 F.3d at 815. Alpenglow has not

[7] Unlike Alpenglow's other arguments, the district court dismissed this claim solely within the context of Alpenglow's Motion for Partial Summary Judgment. *See Alpenglow I*, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *7 ("The only argument . . . remaining in the motion for summary judgment is whether the IRS has failed to produce sufficient evidence that plaintiffs trafficked in a controlled substance."). "We review a district court's grant of summary judgment de novo." *Amparan v. Lake Powell Car Rental Cos.*, 882 F.3d 943, 947 (10th Cir. 2018). "Summary judgment is appropriate 'if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.' " *Id.* (quoting Fed. R. Civ. P. 56(a)). "On appeal, we examine the record and all reasonable inferences that might be drawn from it in the light most favorable to the nonmoving party." *Id.* (internal quotation marks omitted).

satisfied this burden. As the district court noted, the "Amended Complaint contains no allegations related to the IRS'[s] lack of evidence for disallowing plaintiffs' business expenses" and is instead "entirely premised upon the IRS'[s] alleged *lack of authority* to disallow" them. *Alpenglow I*, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *7.

Rather than challenge the district court's conclusion, Alpenglow relies on 26 U.S.C. § 7491 and argues that once it raised the allegation that the IRS lacked evidence of Alpenglow's purported trafficking, "the burden shifted to the Government as a matter of law to show it actually had the evidence." Aplt. Br. at 29 (citing 26 U.S.C. § 7491). But § 7491 states:

> If, in any court proceeding, *a taxpayer introduces credible evidence* with respect to any factual issue relevant to ascertaining the liability of the taxpayer . . . , the Secretary shall have the burden of proof with respect to such issue.

26 U.S.C. § 7491(a)(1) (emphasis added).

Alpenglow did not make an arbitrariness argument in the Amended Complaint or allege any "credible evidence" that it is not engaged in marijuana trafficking. Thus, even if we assume the burden shifts to the IRS to prove its action was not arbitrary, Alpenglow is not relieved of its initial obligation to provide "credible evidence" that it does not traffic in a controlled substance. By choosing not to advance this theory, or allegations supporting it, in the Amended

Complaint, Alpenglow has waived the claim. *See J.V. v. Albuquerque Pub. Sch.*, 813 F.3d 1289, 1299 (10th Cir. 2016) (holding that "Appellants waived [a disparate impact] basis for ADA liability by omitting it from their complaint").

2. Taxable Income Under the Sixteenth Amendment

Alpenglow next raises a Sixteenth Amendment claim consisting of two arguments: (1) under the constitutional definition of income, ordinary and necessary business expenses must be excluded from gross income calculations; and (2) the IRS improperly disallowed Alpenglow "costs of goods sold" exclusions under § 263A.

a. Ordinary and necessary business expenses

The Sixteenth Amendment grants Congress the 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." For purposes of calculating tax liability, the Internal Revenue Code includes two types of income: "gross income" and "taxable income."

The Tax Code codified the Sixteenth Amendment's definition of income by defining gross income as "all income from whatever source derived, including . . . [g]ross income derived from business." 26 U.S.C. § 61(a); *see Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 432 n.11,

75 S. Ct. 473, 99 L. Ed. 483, 1955-1 C.B. 207 (1955) (*Section 61(a)* "is based upon the 16th Amendment and the word 'income' is used in its constitutional sense." (internal quotation marks omitted)); *Samples v. Comm'r*, T.C. Memo 2009-167, 98 T.C.M. (CCH) 27, *3 (2009) ("*26 U.S.C. section 61(a)* is in full accordance with Congressional authority under the Sixteenth Amendment to the Constitution to impose taxes on income without apportionment among the states." (quoting *Perkins v. Comm'r*, 746 F.2d 1187, 1188 (6th Cir. 1984))). "The starting point in the determination of the scope of 'gross income' is the cardinal principle that Congress in creating the income tax intended to use the full measure of its taxing power." *Comm'r v. Kowalski*, 434 U.S. 77, 82, 98 S. Ct. 315, 54 L. Ed. 2d 252 (1977) (internal quotation marks omitted). To that end, Congress has the unquestioned constitutional and statutory authority to tax gross income. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440, 54 S. Ct. 788, 78 L. Ed. 1348, 1934-1 C.B. 194 (1934). To ensure taxation of *income* rather than sales, the "cost of goods sold" is a mandatory exclusion from the calculation of a taxpayer's gross income. *See Max Sobel Wholesale Liquors v. Comm'r*, 630 F.2d 670, 671 (9th Cir. 1980); *Sullenger v. Comm'r*, 11 T.C. 1076, 1077 (1948); 26 C.F.R. § 1.61-3(a) ("'[G]ross income' means the total sales, less the cost of goods sold. . . ."). Treasury Regulations include "inventory price," "transportation or other necessary charges incurred in acquiring possession of the goods," "cost of raw materials and supplies," "direct labor" costs, and "indirect production costs" as some of the

mandatory exclusions to gross income. 26 C.F.R. § 1.471-3.[8]

In contrast, taxable income is the taxpayer's "gross income minus the deductions allowed" by statute. *26 U.S.C. § 63(a)*. Deductions under *§ 162(a)* are matters

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[8] Cost means:

> **(a)** In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.
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> **(b)** In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods. For taxpayers acquiring merchandise for resale that are subject to the provisions of section 263A, see §§ 1.263A-1 and 1.263A-3 for additional amounts that must be included in inventory costs.
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> **(c)** In the case of merchandise produced by the taxpayer since the beginning of the taxable year, (1) the cost of raw materials and supplies entering into or consumed in connection with the product, (2) expenditures for direct labor, and (3) indirect production costs incident to and necessary for the production of the particular article, including in such indirect production costs an appropriate portion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit. See §§ 1.263A-1 and 1.263A-2 for more specific rules regarding the treatment of production costs.

26 C.F.R. § 1.471-3. "Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes. . . ." *Comm'r v. S. Tex. Lumber Co.*, 333 U.S. 496, 501, 68 S. Ct. 695, 92 L. Ed. 831 (1948).

of "legislative grace" specifically authorized by statute, *see Commodore Mining Co. v. Comm'r*, 111 F.2d 131, 134 (10th Cir. 1940), and "Congress has unquestioned power to condition, limit, or deny deductions from gross income in arriving at the net which is to be taxed," *id.* at 133 (citing *Helvering v. Indep. Life Ins. Co.*, 292 U.S. 371, 381, 54 S. Ct. 758, 78 L. Ed. 1311, 1934-1 C.B. 302 (1934)). One such statutorily-authorized deduction "allows a business to deduct from its gross income 'all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on the trade or business.'" *Olive*, 792 F.3d at 1148 (quoting *26 U.S.C. § 162(a)*). The Supreme Court has defined "ordinary and necessary expenses" as those expenses that are "'appropriate and helpful' to 'the development of the (taxpayer's) business,'" *Colo. Springs Nat'l Bank v. United States*, 505 F.2d 1185, 1191 (10th Cir. 1974) (quoting *Comm'r v. Tellier*, 383 U.S. 687, 689, 86 S. Ct. 1118, 16 L. Ed. 2d 185 (1966)), and "normal[] in the particular business," *id.* at 1193 (quoting *Deputy v. du Pont*, 308 U.S. 488, 496, 60 S. Ct. 363, 84 L. Ed. 416, 1940-1 C.B. 118 (1940)). However, *§ 162(a)* prohibits certain deductions, such as "when the 'amount paid or incurred during the taxable year' is for the purpose of 'carrying on any trade or business consisting of trafficking in controlled substances.'" *Olive*, 792 F.3d at 1148 (quoting 26 U.S.C. § 280E).

Alpenglow does not challenge Congress's authority to limit or deny deductions. Nor does Alpenglow contest that the IRS specifically enumerates nearly all of the challenged expenses listed in the Amended

Complaint as "Deductions." Instead, Alpenglow argues that, despite being listed in the Tax Code as deductions, "certain necessary items like . . . ordinary and necessary [business] expenses" are actually exclusions that, like the cost of goods sold, must be subtracted from the calculation of a business's gross income. *See Davis v. United States*, 87 F.2d 323, 324 (2d Cir. 1937). Consequently, Alpenglow claims § 280E violates the Sixteenth Amendment because it "prevent[s] the deduction of expenses that a business could not avoid incurring." *See* Aplt. Br. at 25; *Alpenglow I*, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *4.

Although there can be similarity between expenses that qualify as cost of goods sold and ordinary and necessary business expenses (such as labor),[9] the cost of goods sold relates to acquisition or creation of the taxpayer's product, while ordinary and necessary business expenses are those incurred in the operation of day-to-day business activities. The cost of goods sold is a well-recognized *exclusion* from the calculation of gross income, while ordinary and necessary business expenses are *deductions*. Indeed, while the Tax Code has statutorily excluded certain expenses from the calculation of gross income, only the cost of goods sold is mandatorily excluded by "[t]he very definition of 'gross

[9] For example, while the cost of labor is typically considered "a subtractable cost of goods sold," Congress has the constitutional authority to "limit[ ] the amount which may be subtracted for income tax purposes, on account of salaries and labor, from the selling price of goods to a 'reasonable allowance' for salaries and wages." *See Pedone v. United States*, 151 F. Supp. 288, 138 Ct. Cl. 233, 239-40 (1957).

income' . . . even in the absence of specific statutory authority for such exclusion." *See Max Sobel*, 630 F.2d at 671. In contrast, ordinary and necessary business expenses have been repeatedly recognized as statutorily-authorized deductions. *See, e.g.*, *Woolford Realty Co. v. Rose*, 286 U.S. 319, 328, 52 S. Ct. 568, 76 L. Ed. 1128, 1932 C.B. 154, 1932-1 C.B. 154 (1932); *Burnet v. Sanford & Brooks Co.*, 282 U.S. 359, 363, 51 S. Ct. 150, 75 L. Ed. 383, 1931-1 C.B. 363 (1931); *United States v. Akin*, 248 F.2d 742, 743-44 (10th Cir. 1957). Although the Supreme Court has never been confronted with the exact argument Alpenglow makes—that necessary business expenses are actually exclusions—the Court has indicated that Congress has the authority to disallow the types of unavoidable expenses Alpenglow identifies.

For example, prior to the enactment of 26 U.S.C. § 280E, the Supreme Court refused the IRS's attempt to deny the cost of rent and wages as ordinary and necessary business expense deductions for a gambling business operating in violation of state law. *Comm'r v. Sullivan*, 356 U.S. 27, 28, 78 S. Ct. 512, 2 L. Ed. 2d 559 (1958). The Court held that, to deny the business "the normal deductions of the rent and wages necessary to operate it" would "come close to making this type of business taxable on the basis of its gross receipts, while all other businesses would be taxable on the basis of net income. *If that choice is to be made, Congress should do it*." *Id.* at 29 (emphasis added); *see also Tellier*, 383 U.S. at 692, 693 ("Deduction of expenses falling within the general definition of *§ 162(a)* may, to

be sure, be disallowed by specific legislation, since deductions are a matter of grace and Congress can, of course, disallow them as it chooses." (internal quotation marks omitted)). And, in passing 26 U.S.C. § 280E, Congress did exactly that by denying ordinary and necessary business expenses incurred by businesses engaged in drug trafficking. Where the Supreme Court proposed that Congress make the choice whether to deny such deductions, we find it difficult to conclude Congress acted unconstitutionally in doing so. It would be strange indeed for the Supreme Court to invite Congress to pass legislation violating the Constitution. It follows then that the business expenses here are deductions, not costs of goods sold. Indeed, the United States Tax Court has expressly reached that same conclusion.

In *Californians Helping to Alleviate Medical Problems*, the United States Tax Court analyzed § 280E and concluded that the ordinary and necessary business expenses associated with operating a medical marijuana business were deniable deductions. *C.H.A.M.P.*, 128 T.C. at 181-82. The tax court noted that the legislative history of § 280E indicates the statute was enacted "as a direct reaction to the outcome of a case in which [the tax] [c]ourt allowed a taxpayer to deduct expenses incurred in an illegal drug trade." *Id.* at 181. That case, *Edmondson v. Comm'r*, permitted the taxpayer to deduct not only the cost of goods sold, but also his "ordinary and necessary" business expenses. T.C. Memo 1981-623, 42 T.C.M. (CCH) 1533 (1981), *superseded by statute*, 26 U.S.C. § 280E. In its report

discussing the enactment of § 280E, the Senate Finance Committee cited *Edmonson* as the impetus for the provision and explained that § 280E was designed to disallow "[a]ll deductions and credits for amounts paid or incurred in the illegal trafficking in drugs." *C.H.A.M.P.*, 128 T.C. at 182 (citation omitted). Tellingly, the report's next sentence stated: "[t]o preclude possible challenges on constitutional grounds, the adjustment to gross receipts with respect to effective costs of goods sold is not affected by this provision of the bill." *Id.* (citation omitted); *see Peyton v. Comm'r,* T.C. Memo 2003-146, 85 T.C.M. (CCH) 1345, *5 (2003) ("[S]ection 280E disallows deductions and credits (but not costs of goods sold) with respect to the sale of controlled substances.").

Alpenglow also argues that, by refusing to allow deductions for unavoidable business expenses, Congress is permitting the IRS to tax its gross receipts rather than its income. But, "it is [not] a violation of due process to impose a tax on gross receipts regardless of the fact that expenditures exceed the receipts. . . . The mere fact of intake being less than outgo does not relieve the taxpayer of an otherwise lawfully imposed tax." *Penn Mut. Indem. Co. v. Comm'r*, 277 F.2d 16, 20 (3d Cir. 1960).

The Internal Revenue Code and United States Tax Court have characterized ordinary and necessary business expenses as discretionary deductions—not mandatory exclusions—to gross income calculations. Congress's choice to limit or deny deductions for these

expenses under § 280E does not violate the Sixteenth Amendment.

b. Costs of goods sold

Alpenglow also claims the IRS improperly denied it an exclusion from income for costs of goods sold. Although Alpenglow did not make this argument until its Motion for Partial Summary Judgment, the district court treated it as part of Alpenglow's Sixteenth Amendment claim and dismissed it under Rule 12(b)(6). The court concluded Alpenglow did not "plausibly allege[] a claim that the IRS improperly disallowed the cost of goods sold [because] the Amended Complaint neither raises such a claim nor alleges any facts in that regard." *Alpenglow I*, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *5. We agree.

In its Amended Complaint, Alpenglow alleges the IRS issued a *Notice of Deficiency* "denying all ordinary and necessary business *deductions* and increasing the income of Alpenglow." *See* Aplt. App. vol. 1, at 197 (emphasis added). The Amended Complaint does not include "costs of goods sold" as one of the denied deductions and nowhere in the Amended Complaint does Alpenglow claim, or allege facts to support, that the IRS's characterization of the denied expenses as deductions—rather than costs of goods sold—was erroneous.

3. *Eighth Amendment*

Alpenglow's third assertion is that § 280E is a penalty and enforcing it violates the *Eighth Amendment*. Our recent decision in *Green Solution*, 855 F.3d 1111, forecloses this argument. *Green Solution* held that "Section 280E is not a penalty," because "[t]he disallowance of a deduction is not an exaction imposed as a punishment. Deductions are not a matter of right. Neither do they turn upon equitable considerations. They are a matter of legislative grace." *Id.* at 1121 (internal quotation marks omitted). Alpenglow contends this conclusion in *Green Solution* is nonbinding dicta. We are not convinced.

In *Green Solution*, the taxpayer argued the district court could assert subject matter jurisdiction over its injunction action against the IRS because § 280E is a penalty, not a tax subject to the AIA. *Id.* We rejected that argument, concluding instead that the attempt to enjoin the IRS's investigation into the applicability of § 280E fell squarely within the jurisdiction-stripping provision of the AIA. *Id.* Because the panel's holding in *Green Solution* that § 280E is not a penalty was necessary to its disposition of the case, that holding was not dicta. *See Bishop v. Smith*, 760 F.3d 1070, 1083 (10th Cir. 2014) ("Statements which appear in an opinion but which are unnecessary for its disposition are dicta."). And although *Green Solution* assessed whether § 280E was a penalty under the Anti-Injunction Act, Alpenglow has offered no reason why the result should be

different under the *Eighth Amendment*. We remain convinced that § 280E is not a penalty.

* * *

Alpenglow has failed to state a claim entitling it to relief because § 280E does not violate the *Eighth* or Sixteenth Amendments and the IRS did not exceed its statutory authority in applying it to deny Alpenglow's business deductions. We therefore affirm the district court's Rule 12(b)(6) Dismissal.

B. Federal Rule of Civil Procedure 59(e) Motion

We turn now to the denial of Alpenglow's Motion to Alter or Amend the Judgment pursuant to Federal Rule of Civil Procedure 59(e). "We review Rule 59(e) decisions for abuse of discretion." *Etherton v. Owners Ins. Co.*, 829 F.3d 1209, 1228 (10th Cir. 2016). "An abuse of discretion is defined in this circuit as judicial action which is arbitrary, capricious, or whimsical." *United States v. Pacheco*, 884 F.3d 1031, 1047 (10th Cir. 2018) (quotation marks omitted). Grounds warranting a motion to alter or amend the judgment pursuant to Rule 59(e) "include (1) an intervening change in the controlling law, (2) new evidence previously unavailable, and (3) the need to correct clear error or prevent manifest injustice." *Servants of the Paraclete v. Does*, 204 F.3d 1005, 1012 (10th Cir. 2000). "Thus, a motion for reconsideration is appropriate where the court has misapprehended the facts, a party's position, or the controlling law." *Id.* "It is not appropriate to revisit

issues already addressed or advance arguments that could have been raised in prior briefing." *Id.* To reverse the district court's denial of a Rule 59(e) motion, "we must have a definite and firm conviction that the lower court made a clear error of judgment or exceeded the bounds of permissible choice in the circumstances." *Etherton*, 829 F.3d at 1228 (internal quotation marks omitted).

1. Motion to Amend the Complaint

"An issue raised for the first time in a motion for summary judgment may properly be considered [as] a request to amend the complaint, pursuant to Federal Rule of Civil Procedure 15." *Pater v. City of Casper*, 646 F.3d 1290, 1299 (10th Cir. 2011). "We therefore construe the district court's refusal to address the new issue as a denial of plaintiffs' request." *Id.* "Although leave to amend shall be freely given when justice so requires," *Las Vegas Ice & Cold Storage Co. v. Far W. Bank*, 893 F.2d 1182, 1185 (10th Cir. 1990) (internal quotation marks omitted), "[t]he decision to grant leave to amend the pleadings is within the discretion of the trial court, and we will not reverse the court's decision absent an abuse of discretion," *Pater,* 646 F.3d at 1299 (internal quotation marks omitted).

In light of our liberalized pleading rules, plaintiffs generally "should not be prevented from pursuing a claim merely because the claim did not appear in the initial complaint." *Id.* at 1299. But plaintiffs cannot "wait until the last minute to ascertain and refine the

theories on which they intend to build their case." *Id.* (quotation marks omitted). We have repeatedly held that, "untimeliness alone is a sufficient reason to deny leave to amend when the party filing the motion has no adequate explanation for the delay." *Id.* (quotation marks omitted); *see Las Vegas Ice & Cold Storage Co.*, 893 F.2d at 1185. And, "[w]here the party seeking amendment knows or should have known of the facts upon which the proposed amendment is based but fails to include them in the original complaint, the motion to amend is subject to denial." *Las Vegas Ice & Cold Storage Co.*, 893 F.2d at 1185 (quotation marks omitted).

In its Rule 59(e) Motion, Alpenglow challenges the district court's Rule 12(b)(6) Dismissal Order and asserts that three of its claims should have been permitted to be advanced in a Second Amended Complaint: (1) the IRS incorrectly disallowed deductions for costs of goods sold under § 263A; (2) the IRS failed to provide any evidence of trafficking to support its denial of Alpenglow's deductions under § 280E; and (3) § 280E violates the *Eighth Amendment*. *Alpenglow II*, 2017 U.S. Dist. LEXIS 65249, 2017 WL 1545659, at *1-3. Alpenglow claimed the court "misapprehended controlling law" by dismissing these claims for failure to sufficiently raise and/or support them in its Amended Complaint rather than treating them as a request to further amend the complaint. 2017 U.S. Dist. LEXIS 65249, [WL] at *1. Alpenglow also asserted that the district court relied on an erroneous public policy

announcement to support its dismissal of Alpenglow's claim.

The district court noted that, although it had the ability to consider the arguments as a request to further amend the complaint, it was not required to do so. *Id.* The court also indicated that, even if it elected to consider Alpenglow's request to amend the complaint, it would deny the motion as untimely because Alpenglow had sufficient facts to raise all three arguments in its original or Amended Complaint. 2017 U.S. Dist. LEXIS 65249, [WL] at *2. And the court noted that it did not make a public policy analysis and would not consider Alpenglow's newly raised "Dead Letter Rule" argument on untimeliness grounds. On appeal, Alpenglow argues this decision was an abuse of the district court's discretion. We have reviewed the district court's decision on each of these claims above and concluded the court did not err in dismissing them for failure to state a claim. We now conclude the district court did not abuse its discretion in refusing to allow Alpenglow to amend its complaint to address the relevant deficiencies.

a. Costs of goods sold

Alpenglow first argues the district court abused its discretion in refusing to grant it leave to amend the complaint to include a claim that the IRS improperly included Alpenglow's cost of goods sold in calculating its tax liability. As discussed above, the district court denied this claim because Alpenglow's Amended

Complaint failed to plausibly allege it. To address this deficiency, Alpenglow attached a proposed Second Amended Complaint to its Rule 59(e) Motion. The critical difference between the two complaints is that Alpenglow's proposed Second Amended Complaint asserts the IRS "den[ied] all ordinary and necessary business deductions, *including* the cost of goods sold," whereas the Amended Complaint made "[t]he same allegation (*minus* reference to cost of goods sold)." *Id.* (emphasis added).

The district court denied the motion to amend the complaint on untimeliness grounds because, despite having all the necessary facts, Alpenglow failed to raise the claim earlier. As discussed above, Alpenglow failed to include the IRS's alleged denial of its cost of goods sold expenses in its Amended Complaint or to challenge the IRS's characterization of its denied expenses as deductions, despite having received the *Notice of Deficiency* and the United States' Motion to Dismiss—both of which claimed the denied deductions *excluded* costs of goods sold. Under these circumstances, the district court's determination that Alpenglow had the facts necessary to raise this argument sooner is not "a clear error of judgment." *See Etherton*, 829 F.3d at 1228 (quotation marks omitted).

b. Evidence of trafficking

Alpenglow concedes it did not raise the IRS's alleged lack of trafficking evidence in the Amended Complaint, but claims it could not have done so because

"the fact that the IRS did not have any evidence of purported trafficking came about due to the representations made by the IRS in its response to the Plaintiff's Motion for Summary Judgment." Aplt. Br. at 33. But, in its Motion for Partial Summary Judgment on this issue, Alpenglow cites the IRS's failure to make factual findings establishing the purported trafficking conduct in the *Notice of Deficiency* as evidence of the arbitrariness of the IRS's decision. Because Alpenglow received the *Notice of Deficiency* before it filed its initial complaint, as well as its Amended Complaint, the district court's conclusion that Alpenglow had all the necessary facts to argue this claim sooner is not "a clear error of judgment." *See Etherton*, 829 F.3d at 1228 (quotation marks omitted).

c. Eighth Amendment

Unlike its other arguments on appeal, Alpenglow's claim that § 280E violates the *Eighth Amendment* was raised in the Amended Complaint and dismissed by the district court under Federal Rule of Civil Procedure 12(b)(6). *See Alpenglow II*, 2017 U.S. Dist. LEXIS 65249, 2017 WL 1545659, at *2. The district court held Alpenglow did not raise a plausible *Eighth Amendment* claim because "[t]he Amended Complaint is entirely devoid of any allegations pertaining to the effect that § 280E has had on plaintiffs' ability to do business." *Alpenglow I*, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *6. Although Alpenglow argues the district court should have allowed it to amend the complaint to allege sufficient factual allegations to support

its *Eighth Amendment* argument, we have concluded that § 280E is not a penalty and thus does not violate the *Eighth Amendment*. So any amendment to the complaint would be legally futile and the district court did not abuse its discretion by denying the motion. *See United States v. Greer*, 881 F.3d 1241, 1244 (10th Cir. 2018), *petition for cert. filed*, 17-8775 (May 4, 2018). ("We are not bound by the district court's reasoning and may affirm on any ground adequately supported by the record." (internal quotation marks omitted)).

2. Public Policy/Dead Letter Rule

Alpenglow raises two distinct but related policy arguments to support its claim that the IRS should not be permitted to apply § 280E to tax the gross income, rather than the net income, of marijuana dispensaries operating in accordance with state law. For the reasons discussed below, we reject both arguments and conclude the district court acted well within its discretion in denying Alpenglow's Rule 59(e) Motion with respect to this claim.

First, Alpenglow asserts that, in its order granting the United States' Motion to Dismiss, the district court conducted an inaccurate analysis regarding the "public policy exception" to the requirement that taxpayers be taxed on net income and that "the court relied upon this analysis, at least in part, in its rulings." Aplt. Br. at 34. In support, Alpenglow quotes the district court's statement: "[i]t is at least arguable whether allowing a taxpayer to deduct from its gross income expenses

incurred in allegedly selling marijuana to the public frustrates the policy of the CSA." *Alpenglow I*, 2016 U.S. Dist. LEXIS 183041, 2016 WL 7856477, at *5 n.2. According to Alpenglow, this comment shows the district court conducted a public policy analysis and concluded the state-approved sale of medical marijuana frustrates a sharply-defined public policy. Alpenglow takes issue with this inferred conclusion, but we need not address it here. The district court clarified in its order denying the Rule 59(e) Motion that the public policy discussion was "entirely irrelevant to the [c]ourt's ultimate finding," *Alpenglow II*, 2017 U.S. Dist. LEXIS 65249, 2017 WL 1545659, at *3, and "had nothing to do with resolving the issue before the [c]ourt: plaintiffs' argument that the Constitution forbids including in gross income the cost of ordinary and necessary business expenses," 2017 U.S. Dist. LEXIS 65249, [WL] at *4.

Second, Alpenglow relies on *Sterling Distributors, Inc. v. Patterson*, to claim there is a "generally accepted" Dead Letter Rule prohibiting the IRS from denying deductions under a law "[w]hen there is a public policy of non-enforcement of the law." Aplt. Br. at 39, 40 (citing 236 F. Supp. 479, 483-84 (N.D. Ala. 1964)). First, Alpenglow has failed to demonstrate any widespread acceptance or adoption of the "Dead Letter Rule" announced in *Sterling Distributors*. To the contrary, the Supreme Court has held that a public policy analysis on the disallowance of deductions under the Tax Code is only appropriate "where Congress has been wholly silent," *Tellier*, 383 U.S. at 693, because "[d]eduction of

expenses falling within the general definition of *§ 162(a)* may, to be sure, be disallowed by specific legislation, since deductions 'are a matter of grace and Congress can, of course, disallow them as it chooses,'" *id.* (quoting *Sullivan*, 356 U.S. at 28). *See also Sullivan*, 356 U.S. at 29 ("If th[e] choice [to tax illegal business on the basis of gross income] is to be made, Congress should do it."). Congress has not been silent here; by enacting § 280E, Congress has spoken expressly on its intent to prohibit the deduction of business expenses related to drug trafficking illegal under federal law.

Second [sic], even assuming the existence of a Dead Letter Rule, Alpenglow cannot succeed on such a theory. The district court refused to consider this argument because Alpenglow "failed to raise it when [it] could have done so at any time during the parties' pre-Judgment briefing." *Alpenglow II*, 2017 U.S. Dist. LEXIS 65249, 2017 WL 1545659, at *3 n.4. The district court did not abuse its discretion in failing to consider this untimely argument. *See Las Vegas Ice & Cold Storage Co*., 893 F.2d at 1185. Furthermore, the Department of Justice has specifically rescinded its former policy of non-prosecution for marijuana dispensaries complying with state law, evidencing governmental intent to enforce this law. *See* Memorandum from Jefferson B. Sessions, Att'y Gen., U.S. Dep't of Justice for all U.S. Att'ys (Jan. 4, 2018). As such, § 280E would not constitute a Dead Letter Rule, even if such a rule existed.

* * *

The district court was not "arbitrary, capricious, or whimsical" in holding that Alpenglow's request to amend the complaint was untimely. *See Pacheco*, 884 F.3d at 1047. Therefore, the court did not abuse its discretion in denying Alpenglow's Rule 59(e) Motion.

III. CONCLUSION

We AFFIRM the dismissal of Alpenglow's suit under Federal Rule of Civil Procedure 12(b)(6) and the denial of Alpenglow's Motion to Alter or Amend the Judgment pursuant to Federal Rule of Civil Procedure 59(e).

2016 U.S. Dist. LEXIS 183041

United States District Court for the
District of Colorado

December 1, 2016, Decided; December 1, 2016, Filed

Case No. 16-cv-00258-RM-CBS

ALPENGLOW BOTANICALS, LLC, et al., Plaintiffs, v. UNITED STATES OF AMERICA, Defendant.

Counsel: For Alpenglow Botanicals, LLC, a Colorado Limited Liability Company, Plaintiff: Richard Allan Walker, Thornburn [sic] Walker, LLC, Greenwood Village, COI James David Thorburn, Thornburn [sic] Walker, LLC, Greenwood Village, CO.

For Charles Williams, an individual, Plaintiff: James David Thorburn, Thornburn [sic] Walker, LLC, Greenwood Village, CO.

For Justin Williams, an individual, Plaintiff: James David Thorburn, Thornburn [sic] Walker, LLC, Greenwood Village, CO.

For USA, Defendant: Goud P. Maragani, U.S. Department of Justice-DC-Tax Division-#683, Washington, DC; Lindsay Laurie Clayton, U.S. Department of Justice-DC-Tax Division-#683, Washington, DC.

Judges: RAYMOND P. MOORE, United States District Judge.

Opinion by: RAYMOND P. MOORE

Opinion

OPINION AND ORDER

On February 3, 2016, plaintiffs Alpenglow Botanicals, LLC ("Alpenglow"), Charles Williams, and Justin Williams (collectively, "plaintiffs") filed a Complaint against defendant the United States of America ("defendant"), seeking declaratory, injunctive, and monetary relief so as to overturn the Internal Revenue Service's ("IRS") decision to deny deductions to income obtained during the course of plaintiffs' business for the tax years 2010, 2011, and 2012. (ECF No. 1.) More specifically, plaintiffs raised the following claims: (1) the IRS went beyond its jurisdiction in administratively determining that plaintiffs were not entitled to certain deductions pursuant to 26 U.S.C. § 280E ("§ 280E"); (2) Congress exceeded its power under the Sixteenth Amendment in passing § 280E; (3) the IRS violated the *Fifth Amendment* in taking evidence from plaintiffs without informing them that they were under investigation for violating the Controlled Substances Act ("the CSA"); and (4) § 280E violates the *Eighth Amendment's* prohibition on excessive fines and penalties. (*Id.*)

On April 19, 2016, defendant filed a motion to dismiss the Complaint ("the motion to dismiss"), pursuant to Fed.R.Civ.P. 12(b)(1) ("Rule 12(b)(1)") and Fed.R.Civ.P. 12(b)(6) ("Rule 12(b)(6)"). (ECF No. 11.) Defendant asserts that the IRS properly determined that plaintiffs were not entitled to deductions pursuant to § 280E, plaintiffs' claims for relief are meritless,

and this Court lacks subject matter jurisdiction to issue an injunction. (*Id.*) Plaintiffs have responded in opposition to the motion to dismiss (ECF No. 12), and defendant has filed a reply (ECF No. 17). Plaintiffs then requested oral argument as to the motion to dismiss (ECF No. 18), which the Court granted (ECF No. 23), holding a hearing on June 23, 2016, and taking the motion to dismiss under advisement (ECF No. 29).

Just prior to the oral argument hearing, plaintiffs filed a Motion for Order to Certify Question of Constitutionality of Colorado's Medical Marijuana Laws to Colorado State Attorney General Pursuant to 28 U.S.C. § 2403(b) ("the motion to certify") (ECF No. 26). Plaintiffs assert that this Court should certify to the Colorado State Attorney General that the constitutionality of Colorado's medical marijuana laws has been questioned. (*Id.*) Defendant has responded to the motion to certify (ECF No. 33), and plaintiffs have filed a reply (ECF No. 35). At the oral argument hearing, the Court also took under advisement the motion to certify. (ECF No. 29.)

Following the oral argument hearing, plaintiffs filed a Motion to Amend Complaint ("the motion to amend"), by which plaintiffs sought to allege further detail as to the specific deductions that the IRS denied. (*See* ECF No. 30; ECF No. 32-1 at ¶ 11.) Plaintiffs also sought to delete any suggestion that the IRS was required to provide plaintiffs with *Miranda* warnings prior to taking evidence from them. (ECF No. 32-1 at ¶ 22.) Defendant has filed a response to the motion to

amend (ECF No. 34), and plaintiffs have filed a reply (ECF No. 37).

Finally, on August 25, 2016, plaintiffs filed a Motion for Partial Summary Judgment Refund Claim ("the motion for summary judgment"). (ECF No. 40.) Plaintiffs assert that they are entitled to summary judgment because the IRS has not produced any evidence that plaintiffs trafficked in a controlled substance, plaintiffs properly capitalized business expenses as costs of goods sold, the IRS does not have authority to investigate violations of criminal statutes, and the Sixteenth Amendment requires that plaintiffs' ordinary and necessary business expenses be removed from their income. (*Id.*) Defendant has filed a response to the motion for summary judgment, asking that the same be denied on the merits, denied without prejudice pending resolution of the motion to dismiss, or denied without prejudice so that defendant may engage in discovery. (ECF No. 42). Plaintiffs have filed a reply. (ECF No. 46.)

I. Legal Standard

Motions to dismiss for lack of subject matter jurisdiction take two principal forms: (1) a facial attack, or (2) a factual attack on the allegations in the complaint. *Holt v. United States*, 46 F.3d 1000, 1002 (10th Cir. 1995). Here, defendant facially attacks the sufficiency of the allegations in the Complaint. (*See* ECF No. 11 at 9-12.) As a result, this Court accepts the allegations in

the Complaint as true for purposes of any jurisdictional analysis. *Holt*, 46 F.3d at 1002.

In evaluating a motion to dismiss under Rule 12(b)(6), a court must accept as true all well-pleaded factual allegations in the complaint, view those allegations in the light most favorable to the non-moving party, and draw all reasonable inferences in the plaintiff's favor. *Brokers' Choice of America, Inc. v. NBC Universal, Inc*., 757 F.3d 1125, 1135-36 (10th Cir. 2014); *Mink v. Knox*, 613 F.3d 995, 1000 (10th Cir. 2010). In the complaint, the plaintiff must allege a "plausible" entitlement to relief. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555-556, 127 S.Ct. 1955, 167 L. Ed. 2d 929 (2007). Conclusory allegations, however, are insufficient. *Cory v. Allstate Ins*., 583 F.3d 1240, 1244 (10th Cir. 2009). A complaint warrants dismissal if it fails "*in toto* to render [plaintiff's] entitlement to relief plausible." *Twombly*, 550 U.S. at 569 n.14.

II. Factual Background

The facts as alleged in the Complaint are as follows. Alpenglow is a Colorado company that does business in the State. (ECF No. 1 at ¶ 1.) Charles Williams and Justin Williams are owner/operators of Alpenglow. (*Id.* at ¶¶ 2-3.) Alpenglow is a "pass through" entity, which means that income and tax liability pass through to its owners. (*Id.* at ¶ 7.) Alpenglow filed federal and State tax returns for the years 2010 through 2012. (*Id.* at ¶ 6.) Alpenglow's tax liability for the years

2010 through 2012 passed through to Charles Williams and Justin Williams. (*Id.* at ¶ 8.)

Alpenglow's tax returns for the years 2010 through 2012 were audited by the IRS. (*Id.* at ¶ 9.) As a result of the audit process, the IRS issued a Form 921 on December 21, 2014, denying deductions and increasing the income of Alpenglow. The deductions were denied because the IRS administratively determined that Alpenglow committed the crime of trafficking in a controlled substance in violation of the CSA. (*Id.*) Charles Williams and Justin Williams paid the increased tax liability under protest, and filed claims for refunds. (*Id.* at ¶¶ 12-13.) Thereafter, the IRS either denied the claims for refunds or did not respond to the claims within 180 days, which acted as a denial. (*Id.* at ¶ 13.)

In the Amended Complaint, plaintiffs allege that the deductions denied were: rent for where the business was conducted; costs of labor; compensation of officers; advertizing [sic]; taxes and licenses for doing business; depreciation; and other wages and salaries. (ECF No. 32-1 at ¶ 11.)

III. Discussion

As an initial matter, the Court explains the order in which it will address the pending motions. The motion to amend (ECF No. 30) is GRANTED. The changes made in the Amended Complaint provide greater detail on the type of expenses for which plaintiffs sought a deduction, as well as (sensibly) removing any

suggestion that the IRS was required to read *Miranda* warnings to plaintiffs. There is no reason why the complaint should not be amended to make these changes. Whether the complaint as amended remains subject to dismissal is a matter that is best left while resolving the motion to dismiss, which the Court will not require defendant to re-file simply because the complaint has been amended.

In their reply in support of the motion for summary judgment, plaintiffs assert that resolution of the motion to dismiss should be subsumed into resolution of the motion for summary judgment because the two motions have the same subject matter. (ECF No. 46 at 1.) The Court does not entirely agree that the motion to dismiss and motion for summary judgment involve the same subject matter. The motion for summary judgment seeks summary judgment with respect to: (1) plaintiffs' Sixteenth Amendment claim that its business expense deductions are constitutionally required; (2) plaintiffs' claim that the IRS does not have authority to investigate whether a criminal statute has been violated; (3) plaintiffs' treatment of costs of goods sold under 26 U.S.C. § 263A being proper; and (4) defendant's failure to produce any evidence showing that § 280E applies to plaintiffs. (ECF No. 40 at 10-19.)

The first two matters are claims brought in the Complaint (and Amended Complaint) and were briefed in the motion to dismiss. Thus, that subject matter is the same. The latter two matters, though, were not mentioned in the Complaint (or Amended Complaint) and were not briefed in the motion to dismiss. They are

entirely new subjects. Thus, where necessary, the Court will address the latter two matters separately. As for the first two matters, they are legal questions, and the parties' arguments with respect thereto are largely the same. To the extent any additional arguments are raised in the motion for summary judgment, the Court will consider those arguments in ruling on the claims. As a result, the Court will address the motion to dismiss first, then any claims remaining from the motion for summary judgment, followed last by the motion to certify.

In the motion to dismiss, defendant seeks dismissal of all claims in this action, as well as plaintiffs' request for injunctive relief. The Court will address the substantive claims first.

A. Does the IRS Have Authority to Disallow Plaintiffs' Deductions?

Depending on the perspective of plaintiffs or defendant, this question could be re-phrased as either: does the IRS have authority to perform a criminal investigation, or does the IRS have authority to enforce the Internal Revenue Code? Perspective matters, and, in this case, defendant's perspective is more accurate of what has occurred.

In a nutshell, plaintiffs' claim with respect to the IRS' authority is premised upon plaintiffs [sic] belief that the IRS, when applying § 280E to a business allegedly engaged in selling medical marijuana, is conducting a criminal investigation of that business. (*See*

ECF No. 12 at 8-11.) In the motion for summary judgment, plaintiffs even go as far as asserting that using § 280E against them amounts to a criminal prosecution. (*See* ECF No. 40 at 18 n.1.) This is simply not what has occurred.

Section 280E provides, in pertinent part, as follows: "[n]o 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 . . . 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. Thus, in order to disallow a deduction, the IRS must determine that a taxpayer carries on a trade or business, and the trade or business trafficks in a controlled substance. Here, it is undisputed that plaintiffs carry on a trade or business. (ECF No. 32-1 at ¶¶ 1, 6.) It can also not be disputed that marijuana is a controlled substance for purposes of the CSA. *See* 21 U.S.C. §§ 802(6), 812. The only bone of contention is whether plaintiffs' business trafficks in marijuana.

Trafficking as used in § 280E means to buy or sell regularly. *Californians Helping to Alleviate Med. Problems v. C.I.R.*, 128 T.C. 173, 182 (T.C. 2007). As such, the real issue here is whether the IRS has authority to determine if, in the course of plaintiffs' business, they regularly bought or sold marijuana. The Court cannot understand why not. Such a determination does not require any great skill or knowledge, certainly not skill

or knowledge of a criminal investigatory bent. It does not require detectives, agents, or any other form of law enforcement personnel to carry out. It should simply require a perusal of plaintiffs' receipts, or even a visit to plaintiffs' business establishment. It is not as if plaintiffs are some underground drug conspiracy, perhaps needing law enforcement investigation to unearth the criminal underbelly of their operation. According to defendant, they are simply a medical marijuana dispensary, dispensing medical marijuana to the public. No great investigation, criminal or otherwise, should be required to determine whether plaintiffs are indeed, in fact, buying or selling on a regular basis marijuana.

In any event, even if a business' operations were of a more secretive nature, there is nothing in the language of § 280E that requires a criminal investigatory entity to delve into any such secretive business practices. Section 280E is placed in the *Internal Revenue* Code, and instructs that deductions should be disallowed if certain circumstances exist in a taxpayer's business. It would certainly be strange if the *Internal Revenue* Service was not charged with enforcing that provision. The fact that selling marijuana may also constitute a violation of the CSA is simply a byproduct of § 280E using the CSA's definition of "controlled substances." Section 280E does not require that a criminal investigation be pursued against a taxpayer, or even that § 280E only applies if a criminal conviction under the CSA has been obtained. If Congress had wanted such an investigation to be carried out or conviction to

be obtained, then it could easily have placed such language in § 280E. It did not, however.

Plaintiffs assert repeatedly that § 280E requires the IRS to find that a crime has been committed and/or that a taxpayer has engaged in illegal activity. (*See* ECF No. 12 at 8-11; ECF No. 40 at 16-19.) Even if these assertions are accurate, this does not transform the IRS' determination that § 280E applies into a criminal investigation, a criminal prosecution, or somehow the rendering of a criminal verdict. There is absolutely no plausible allegation in the Amended Complaint that plaintiffs have been investigated, charged, or prosecuted criminally for their alleged business activities in 2010, 2011, or 2012. By *criminal*, the Court means a criminal case or prosecution being prepared or filed against plaintiffs.

In their motion for summary judgment, plaintiffs attempt to manufacture a criminal prosecution against themselves, asserting that enforcement of § 280E amounts to such a prosecution, citing *Dep't of Revenue of Montana v. Kurth Ranch*, 511 U.S., 767, 114 S.Ct. 1937, 128 L. Ed. 2d 767 (1994). (*See* ECF No. 40 at 8-9, 18 n.1.) To whatever extent *Kurth Ranch* is relevant here, it is notable that the Supreme Court stated that "Montana no doubt could collect its tax on the possession of marijuana, for example, if it had not previously punished the taxpayer for the same offense." *Kurth Ranch*, 511 U.S. at 778. Here, as discussed, there is no plausible allegation that plaintiffs have been punished

previously for allegedly selling marijuana in 2010, 2011, and 2012.[1]

Ultimately, although some taxes may be considered punishment for purposes of double jeopardy, there is no double jeopardy concern plausibly alleged here. Moreover, § 280E does not require that the IRS wait for another governmental unit to investigate a taxpayer's trade or business before the IRS can disallow a deduction. Therefore, the Court finds that § 280E provides the IRS with the authority to make the factual determinations necessary to decide whether that provision applies to a taxpayer's trade or business.

B. Does Section 280E Violate the Sixteenth Amendment?

With respect to this claim, plaintiffs effectively argue that the manner in which the IRS applies § 280E is unconstitutional because, in applying the provision, the IRS prevents a taxpayer from deducting business expenses. (ECF No. 12 at 12-13.) In the motion for summary judgment, plaintiffs go as far to assert that the business expenses disallowed in this case are "constitutionally mandated." (ECF No. 40 at 12.) For this proposition, plaintiffs rely upon *Davis v. United States*,

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[1] In fact, as plaintiffs go to great pains to point out (*see* ECF No. 40 at 5, 18), it would be very difficult for defendant to prosecute plaintiffs. *See United States v. McIntosh*, 833 F.3d 1163, 1177-78 (9th Cir. 2016) (holding that Congress has prohibited the Department of Justice from prosecuting individuals who are engaged in conduct permitted by State medical marijuana laws and who fully complied with those laws).

87 F.2d 323 (2d Cir. 1937) (*see* ECF No. 12 at 13; ECF No. 40 at 12), which, itself, relies upon *Eisner v. Macomber*, 252 U.S. 189, 40 S.Ct. 189, 64 L. Ed. 521, 1920-3 C.B. 25, T.D. 3010 (1920). *See Davis*, 87 F.2d at 324. In *Eisner*, the Supreme Court described income "as the gain derived from capital, from labor, or from both combined." *Eisner*, 252 U.S. at 207 (quotation omitted). Relying upon *Eisner*, in *Davis*, the Second Circuit Court of Appeals concluded that taxable income equaled gross income minus, *inter alia*, "ordinary and necessary expenses incurred in getting the so-called gross income." *Davis*, 87 F.2d at 324.

However, the Second Circuit's explanation of taxable income is dicta, *see id*. at 325, and the Supreme Court itself has placed its decision in *Eisner* into context. Notably, in *C.I.R. v. Glenshaw Glass Co*., 348 U.S. 426, 430-431, 75 S.Ct. 473, 99 L. Ed. 483, 1955-1 C.B. 207 (1955), the Supreme Court explained that the characterization of income in *Eisner* served a useful purpose for distinguishing gain from capital, "[b]ut it was not meant to provide a touchstone to all future gross income questions." Moreover, as plaintiffs acknowledge, the business expenses at issue here are deductions. (ECF No. 32-1 at ¶¶ 9-11.) This means that Congress allows a taxpayer to deduct those expenses from his or her gross income. As such, deductions "depend[ ] upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed." *C.I.R. v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149, 94 S.Ct. 2129, 40 L. Ed. 2d 717 (1974).

In this light, it is clear that what plaintiffs really seek with respect to this claim is for this Court to find that, constitutionally, gross income cannot include the cost of ordinary and necessary business expenses. Apart from the perhaps more philosophical question of whether expenses incurred in carrying on a business allegedly engaged in an enterprise illegal under federal law can ever be described as 'ordinary' or 'necessary,'[2] plaintiffs point to no case law holding this proposition to be true. Instead, the only item that must be excluded in order to produce gross income is the cost

[2] In that regard, an interesting case is *C.I.R. v. Heininger*, 320 U.S. 467, 64 S.Ct. 249, 88 L. Ed. 171, 1944 C.B. 484 (1943). In *Heininger*, the Commissioner of Internal Revenue denied a taxpayer's litigation expenses as deductible on the ground that they were not ordinary and necessary. *Id.* at 470. The litigation expenses had been incurred in the taxpayer's attempt to challenge the issuance of a fraud order against it, which would have resulted in the destruction of its business. *Id.* at 469. The Supreme Court concluded that the litigation expenses were both ordinary and necessary, and that, for the expenses to be denied deduction, "it must be because allowance of the deduction would frustrate the sharply defined policies of [the relevant statute]." *Id*. at 471-474. The Supreme Court noted that the purpose of the relevant statute was to protect the public from fraudulent practices, and then concluded that the litigation expenses did not frustrate this policy because they were incurred in order to present a bone fide defense to a proposed fraud order. *Id*. at 474. Here, the purpose and policy of the CSA is to protect the public from various drugs, including marijuana. It is at least arguable whether allowing a taxpayer to deduct from its gross income expenses incurred in allegedly selling marijuana to the public frustrates the policy of the CSA. This is especially so here where Congress has specifically legislated that such amounts should not be allowed. *Cf. id*. at 474-475 (noting that Congress had not "expressly or impliedly indicated" that the punitive consequences of denying the deduction should result).

of goods sold. *See Anderson Oldsmobile v. Hofferbert*, 102 F. Supp. 902, 905-906 (D. Md. 1952) (explaining that "the cost of goods sold must be deducted from gross receipts in order to arrive at gross income.").

In the motion to dismiss, defendant asserted that it disallowed Alpenglow's deductions "except for cost of goods sold." (ECF No. 11 at 7.) In their response, plaintiffs did not challenge this statement (*see generally* ECF No. 12), and defendant reiterated it in reply (ECF No. 17 at 9-11). However, in the motion for summary judgment, plaintiffs asserted, for the first time and in unexplained fashion, that the IRS denied the cost of goods sold. (*See* ECF No. 40 at 12.) In turn, defendant did not respond to this new assertion (*see generally* ECF No. 42), and plaintiffs reiterated it in their reply (ECF No. 46 at 6). Evidently burying one's head in the sand is not a characteristic unique to either side in this case. Ultimately, however, the fault here falls on plaintiffs' side because there are absolutely no allegations in the Amended Complaint that the IRS disallowed the cost of goods sold in disallowing plaintiffs' alleged business expenses. Notably, the Amended Complaint characterizes the expenses as "business deductions," rather than the cost of goods sold. (*See* ECF No. 32-1 at ¶¶ 9-11.) Therefore, the Court cannot find that plaintiffs have plausibly alleged a claim that the IRS improperly disallowed the cost of goods sold when the Amended Complaint neither raises such a claim nor alleges any facts in that regard.

As a result, because the Amended Complaint fails to plausibly allege that the IRS disallowed any

expenses or costs that the Sixteenth Amendment, or the Constitution generally, requires be allowed, plaintiffs have failed to allege a plausible Sixteenth Amendment claim.

C. Did the IRS' Application of Section 280E Violate the *Fifth Amendment*?

This claim, much like the claim that the IRS does not have authority to apply § 280E, is premised upon plaintiffs' belief that, in applying that provision, the IRS is performing a criminal investigation of plaintiffs. Specifically, plaintiffs allege that the IRS should have informed plaintiffs that they were under investigation for violating the CSA, citing *United States v. Tweel*, 550 F.2d 297 (5th Cir. 1977). (ECF No. 32-1 at ¶ 22.) Apart from the fact that *Tweel* is a *Fourth Amendment* case, rather than a *Fifth Amendment* one, *see Tweel*, 550 F.2d at 299, the decision was based upon an IRS agent's "sneaky deliberate deception," which vitiated the defendant's consent to search, *id* at 299-300. This is not the issue here, and thus, *Tweel* in [sic] not applicable. In their response to the motion to dismiss, plaintiffs assert that the information obtained from them "was being used to develop findings of criminal wrongdoing." (ECF No. 12 at 12.) As an initial matter, the Court, even at this stage, is entirely unaware of what "information" the IRS has obtained in this case. In any event, whatever information has been obtained was not acquired in order to make findings of criminal wrongdoing. As the Court found *supra*, here, the IRS

determined that § 280E applied, which is a purely tax-based determination.

As a result, plaintiffs have failed to allege a plausible *Fifth Amendment* claim.

D. Did Application of Section 280E Violate the *Eighth Amendment*?

Plaintiffs allege that § 280E is disguised as a forfeiture provision in that it requires the forfeiture of a taxpayer's entire income and capital. (ECF No. 32-1 at ¶ 24.) In their response to the motion to dismiss, plaintiffs explain further that application of § 280E "will deal a fatal blow to their business," will "make it impossible" to continue their business, and "will quickly stamp out all of Colorado's legalized marijuana industry." (ECF No. 12 at 16-18.) Plaintiffs assert that such an "industry-ending effect" constitutes a penalty and an excessive fine for purposes of the *Eighth Amendment*. (*Id.*) Simply put, despite plaintiffs' assertions in their response about the crippling nature of § 280E, no such assertions are made in the Amended Complaint. The Amended Complaint is entirely devoid of any allegations pertaining to the effect that § 280E has had on plaintiffs' ability to do business, or whether, as the plaintiffs suggest, doing their business is now impossible. (*See generally* ECF No. 32-1.) Thus, even if the Court were inclined to consider that application of § 280E amounted to a "penalty," it is entirely unable to assess whether such a penalty would be excessive for purposes of the *Eighth Amendment*.

As a result, plaintiffs have failed to allege a plausible *Eighth Amendment* claim.[3]

E. The Motion for Summary Judgment

In light of the findings *supra*, the Court denies the motion for summary judgment with respect to whether the IRS improperly denied the cost of goods sold, whether the IRS has authority to apply § 280E, and whether the application of § 280E violates the Sixteenth Amendment.

The only argument the Court can discern remaining in the motion for summary judgment is whether the IRS has failed to produce sufficient evidence that plaintiffs trafficked in a controlled substance. In part, plaintiffs frame this issue as a burden of proof question. In other words, according to plaintiffs, because § 280E is a penalty, the Internal Revenue Code places the burden of production upon the IRS to establish that a taxpayer is liable for the penalty. (*See* ECF No. 40 at 8-10, 12-15.) Plaintiffs assert that the evidence the IRS will use to establish that they trafficked in a controlled substance is "entirely mysterious," as the IRS' Notice of Deficiency had no findings of fact establishing trafficking. (*Id.* at 15.)

Under other circumstances the Court might be inclined to agree with at least some of the assertions

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[3] Because the Court finds that none of the claims raised in the Amended Complaint are plausible, plaintiffs' request for injunctive relief is DENIED.

plaintiffs proffer.[4] However, the Amended Complaint contains no allegations related to the IRS' lack of

[4] It is notable that, in its response to the motion for summary judgment, defendant does not dispute the lack of evidence argument from plaintiffs. Instead, defendant asserts that it "needs additional discovery from Plaintiffs and third parties to bolster its evidentiary support showing that Plaintiffs[ ] trafficked in marijuana during 2010, 2011 and 2012." (ECF No. 42 at 4.) Defendant fails, though, to explain precisely what evidentiary support it already has, i.e., the evidence that needs to be bolstered. All defendant has pointed to so far is plaintiffs' website (*id.*), which is a dubious bases [sic] at best to conclude that plaintiffs' trafficked in a controlled substance years ago. Based upon defendant's assertions in response to the motion for summary judgment, it would appear that the IRS has no evidence (other than plaintiffs' website) to support its determination that § 280E applies to plaintiffs' business. A pertinent case in this regard is *Franklin v. C.I.R.*, T.C. Memo 1993-184, 65 T.C.M. (CCH) 2497 (T.C. 1993). In *Franklin*, the Commissioner of Internal Revenue issued a notice of deficiency with respect to the taxpayer's failure to report income from alleged sales of heroin. T.C. Memo 1993-184, *Id*. at *3. The notice of deficiency provided no information about the items of income (other than the amount), and no basis for determining how the amounts were calculated. *Id.* The Tax Court explained that, although a presumption of correctness attaches to the Commissioner's determination, the presumption fails if a taxpayer can show that the Commissioner did not link him to an illegal tax-generating act. T.C. Memo 1993-184, *Id*. at *4. The taxpayer makes an insufficient showing "if it is established that his involvement with an unlawful activity is direct enough to support the inference that he received or used funds in the course of his engagement in that activity." *Id.* The Tax Court found that there was sufficient evidence from which to infer the taxpayer's engagement in unlawful activities in light of the taxpayer having pled guilty to specific acts of heroin distribution during the years in question. T.C. Memo 1993-184, *Id*. at *4-5. In addition, the Tax Court found that the taxpayer failed to establish the Commissioner's determination was arbitrary based solely on the Commissioner's failure to demonstrate a rational basis for the same. T.C.

evidence for disallowing plaintiffs' business expenses. The Amended Complaint is entirely premised upon the IRS' alleged *lack of authority* to disallow plaintiffs' business expenses, as well as the alleged constitutional violations resulting from doing so. There are no allegations that the IRS had a *lack of evidence* to apply § 280E. (*See generally* ECF No. 32-1.) Given that plaintiffs assert that the Notice of Deficiency contained no factual findings of trafficking, plaintiffs could have easily alleged in the Amended Complaint the same issue. Plaintiffs chose not to do so though, and the Court cannot assess a claim that is not even alleged in the Amended Complaint. As a result, the Court denies the motion for summary judgment with respect to plaintiffs' assertion that the IRS has failed to meet its burden of proof in applying § 280E.

F. The Motion to Certify

The motion to certify is premised upon plaintiffs' belief that "the only way that the Court can determine that Colorado's Medical Marijuana Laws must give way to the federal law is to determine that the State of

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Memo 1993-184, *Id*. at 5-6. Here, unlike the taxpayer in *Franklin*, plaintiffs have not pled guilty to trafficking in a controlled substance. Instead, as defendant notes, plaintiffs have refused to admit or deny whether they sold medical marijuana between 2010 and 2012. (*See* ECF No. 42 at 10.) As discussed, the only evidence in the record is plaintiffs' website, which hardly seems to provide the necessary inference of illegal activity, at least not with respect to sales up to six years ago. Thus, if plaintiffs' website is the sole basis upon which the IRS issued the Notice of Deficiency in this case, it very well could have been issued arbitrarily. But, as discussed *infra*, that issue is not properly before the Court.

Colorado violated the Supremacy Clause in adopting the laws." (ECF No. 26 at 2-3.) This statement is based upon a faulty premise, however, as it is not necessary for this Court to determine whether Colorado's medical marijuana laws must give way to federal law in order to resolve the claims raised in the Amended Complaint. The issues here concern the applicability and effect of applying § 280E to plaintiffs' business. Section 280E, in turn, can be applied if the trafficking activity is prohibited by *either* federal or state law. *See* 26 U.S.C. § 280E. Therefore, whether or not federal and state law are in conflict is not relevant here.

IV. Conclusion

For the reasons discussed herein, the Court GRANTS the motion to dismiss (ECF No. 11.) As a result, this case is DISMISSED. The Clerk is instructed to enter judgment in defendant's favor, and CLOSE this case. The Motion to certify (ECF No. 26) and the motion for summary judgment (ECF No. 40) are DENIED. The motion to amend (ECF No. 30) is GRANTED.

SO ORDERED.

DATED this 1st day of December, 2016.

BY THE COURT:

/s/ Raymond P. Moore

RAYMOND P. MOORE

United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
Judge Raymond P. Moore

Case No. 16-cv-00258-RM-CBS

ALPENGLOW BOTANICALS, LLC, *et al.*,

Plaintiffs,

v.

UNITED STATES OF AMERICA,

Defendant.

ORDER

(Filed Apr. 28, 2017)

On December 1, 2016, this Court entered an Opinion, *inter alia*, denying plaintiffs', Alpenglow Botanicals, LLC ("Alpenglow"), Charles Williams, and Justin Williams (collectively, "plaintiffs"), motion for summary judgment and granting defendant's, the United States of America ("defendant"), motion to dismiss. (ECF No. 48.) Final judgment was entered the same day. (ECF No. 49.) Twenty-eight days later plaintiffs filed a motion to alter or amend judgment ("the motion to alter") pursuant to Fed.R.Civ.P. 59(e) ("Rule 59(e)"). (ECF No. 50.) Attached to the motion to alter was a proposed amended version of plaintiffs' Complaint. (ECF Nos. 50-2, 50-3.)[1] Defendant has now filed a

[1] Plaintiffs also subsequently filed a notice containing a new version of their proposed amended Complaint. (ECF Nos. 55-1,

response, and plaintiffs have filed a reply. (ECF Nos. 53, 54.)

I. Legal Standard

Motions attacking a final judgment that are filed within 28 days of entry of the same are reviewed under Rule 59(e). *See Servants of the Paraclete v. Does*, 204 F.3d 1005, 1012 (10th Cir. 2000) (discussing a prior version of Rule 59(e)); *see also* Fed.R.Civ.P. 59(e) ("A motion to alter or amend a judgment must be filed no later than 28 days after the entry of the judgment."). Grounds justifying a motion to alter or amend judgment under Rule 59(e) include "(1) an intervening change in the controlling law, (2) new evidence previously unavailable, and (3) the need to correct clear error or prevent manifest injustice." *Servants of the Paraclete*, 204 F.3d at 1012.

II. Discussion

A. Arguments Related to Amending the Operative Complaint

Plaintiffs assert that this Court misapprehended controlling law when it failed to consider three issues

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55-2.) Plaintiffs assert that this version of the proposed amended Complaint contains an exhibit that should have been, but was not, attached to the original proposed amended Complaint. (ECF No. 55 at 1-2.) As such, to the extent the Court cites to the proposed amended Complaint, the Court will cite to the version filed with plaintiffs' notice, rather than the version originally filed with the motion to alter.

raised for the first time outside of their operative Complaint as a request to amend the Complaint, citing *Pater v. City of Casper*, 646 F.3d 1290 (10th Cir. 2011). (ECF No. 50 at 2-3.) Plaintiffs further assert that leave to amend should be granted because this case is in its early stages, and there would be no prejudice to the parties. (*Id*. at 3.)

Plaintiffs arguments fail in all respects. First, the Court did not fail to consider plaintiffs' newly raised allegations. The Court more than thoroughly considered each, and found that plaintiffs had failed to raise those allegations in their operative Complaint. (ECF No. 48 at 11, 13-15.) *Pater* requires nothing more. In *Pater*, the Tenth Circuit Court of Appeals explained that an issue raised for the first time in a motion for summary judgment "*may* properly be considered a request to amend the complaint. . . ." *Pater*, 646 F.3d at 1299 (emphasis added). Notably, in *Pater*, the district court did not address an argument "[p]resumably" because it had been raised for the first time in a motion for summary judgment. The Tenth Circuit, thus, construed the district court's refusal to address the new issue as a denial of plaintiff's request to amend, and concluded that the court did not err in failing to consider the issue. *Id*. In this light, *Pater* certainly does not require the Court to address in writing newly raised issues. This is especially the case, here, where plaintiffs are represented by counsel. If plaintiffs wished to add new allegations to their operative Complaint, then they should have requested leave to do so. Otherwise, the Court would have been forced to engage

in its own debate as to the legal merit of plaintiffs' undisclosed request. The Court would have been forced to conjure up plaintiffs' arguments in favor of amending the Complaint, defendant's response in opposition, and then decide which of the Court's split personalities had won. The Court does not find such a contention to be the controlling law. As such, the Court does not find that it has misapprehended controlling law.

Second, even if the Court were predisposed to now consider plaintiffs' request for leave to amend their Complaint, the Court would not grant the request. As the Court stated in its December 1, 2016 Opinion with respect to plaintiffs' newly raised argument about defendant's having a lack of evidence to apply 26 U.S.C. § 280E ("§ 280E"), plaintiffs could have raised that argument when they first brought this case. (ECF No. 48 at 14-15.) To the extent it was not clear in that earlier Opinion, the same is true of the other two issues plaintiffs newly raised.

Plaintiffs' first newly raised argument concerns whether defendant disallowed costs of goods sold under "IRC 263A". (ECF No. 50 at 2.) As the allegations in the proposed amended Complaint make clear, defendant issued a Form 921 on *December 11, 2014*, denying all ordinary and necessary business deductions, including the cost of goods sold. (ECF No. 55-2 at ¶ 9.) The same allegation (minus reference to cost of goods sold), citing to the same Form 921, was made in the iteration of the Complaint (the first amended complaint) considered in the Court's December 1, 2016 Opinion. (*See* ECF No. 30-1 at ¶ 9.) Plaintiffs' request

with respect to this argument is particularly egregious because, in allowing the first amended complaint to become the operative Complaint, the Court allowed plaintiffs to more fully delineate the "nature of the deductions" at issue. (*See* ECF No. 30 at 1-2.) Despite purporting to do that, plaintiffs failed to include § 263A costs, even though those costs were specifically included in the exhibit attached to the first amended complaint. (*See* ECF No. 30-2 at 1.) As such, plaintiffs could have easily raised this claim when they first filed this case.

The same is true of plaintiffs' third newly raised argument that § 280E violates the Eighth Amendment. (ECF No. 50 at 2.) As the Court explained in its December 1, 2016 Opinion, that argument was raised in the operative Complaint, but plaintiffs failed to allege that § 280E would deal a fatal blow to its business and would stamp out all of Colorado's legalized marijuana industry. (ECF No. 48 at 13.) Instead, in the operative Complaint all that plaintiffs alleged, conclusorily, was that § 280E was a "forfeiture provision requiring the forfeiture of the entirety of a taxpayer's income and capital." (*See* ECF No. 30-1 at ¶ 24.) Given that the alleged forfeitures in this case took place, at the latest, in May 2015 when defendant denied Alpenglow's refund claim (*see id*. at ¶ 15), plaintiffs could have easily made the new allegations, which were raised for the first time in their response to the motion

to dismiss, in the original complaint or the first amended complaint.[2]

As the Tenth Circuit stated in *Pater*, "untimeliness alone is a sufficient reason to deny leave to amend when the party filing the motion has no adequate explanation for the delay." *Pater*, 646 F.3d at 1299 (quoting *Frank v. U.S. West, Inc.*, 3 F.3d 1357, 1365-66 (10th Cir. 1993)) (ellipsis omitted).[3] Here, Plaintiffs do not attempt to explain their delay. (*See generally* ECF No. 50.) Instead, construing the motion to alter kindly, it appears that plaintiffs believe that the first and third new arguments/allegations were sufficiently raised in the first amended complaint. (*See* ECF No. 50 at 3-4.)

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[2] With respect to the new allegations in the proposed amended Complaint concerning plaintiffs' Eighth Amendment claim, even if the Court were to consider them as not new, the Court would still not allow leave to amend that claim on futility grounds. Although plaintiffs allege that, if they were required to comply with defendant's interpretation of § 280E, they could not stay in business (ECF No. 55-2 at ¶ 27), there is no plausible suggestion that this is the case. Notably, plaintiffs allege that they have paid their increased tax liability (*id*. at ¶ 15), yet plaintiffs do not allege that they have gone out of business as a result. Given that it appears that plaintiffs paid their increased tax liability at least two years ago (*see id*. at ¶¶ 14-15), the Court does not find plaintiffs allegations about being unable to stay in business to be plausible.

[3] The Court, thus, does not find the Tenth Circuit's citation, in *Minter v. Prime Equip Co.*, 451 F.3d 1196, 1205 (10th Cir. 2006), to a decision of the Third Circuit Court of Appeals where it was stated that delay alone was insufficient to deny leave to amend, as being incompatible with *Frank* and *Pater*, given that, when a party fails to provide an adequate explanation for its delay, the failure to explain should be considered undue delay. *See Minter*, 451 F.3d at 1206 (quoting *Frank*).

In light of the discussion herein and in the December 1, 2016 Opinion that is clearly not the case.

As for the second new argument, concerning defendant's alleged lack of evidence to support application of § 280E, although, arguably, indications of defendant's lack of evidence may have arisen during the course of this litigation, as plaintiffs asserted in their motion for summary judgment, the *Notice of Deficiency* had no findings of fact establishing plaintiffs' purported trafficking in a controlled substance. (*See* ECF No. 40 at 15.) Given that plaintiffs further assert that the Notice of Deficiency was issued "about December 11, 2014" (*id*. at 4), it cannot be said that plaintiffs were without facts necessary to raise a claim related to an alleged lack of evidence.

As a result, the Court finds that plaintiffs are not entitled to leave to amend their Complaint because they have failed to provide any reason (let alone an adequate one) for why they delayed in raising the new allegations they seek to bring. *See Pater*, 646 F.3d at 1299.

B. Argument Without a Procedural Home

The parties spend a great deal of time arguing over whether illegal and legal income should be taxed alike. (*See* ECF No. 50 at 5-7; ECF No. 53 at 8-10; ECF No. 54 at 1-6.) The Court will not be doing so for the simple reason that, even if the Court were willing to accept plaintiffs' argument, it would not cause the Court to alter or amend its Judgment dismissing this

case. The important thing to note with respect to this issue, something which plaintiffs initially note themselves and then apparently unmoor themselves from, is that its origination derives from the Court asking a *philosophical question* in its December 1, 2016 Opinion. In other words, it was (a) not raised by plaintiffs,[4] and (b) entirely irrelevant to the Court's ultimate finding.

Notably, in the December 1, 2016 Opinion, the Court asked the question, which the Court described as "philosophical," whether "expenses incurred in carrying on a business allegedly engaged in an enterprise illegal under federal law can be described as 'ordinary' or 'necessary'. . . ." (ECF No. 48 at 10.) In a footnote, the Court then discussed an issue, one which had not been raised by the parties, regarding whether allowing certain business deductions would frustrate the sharply defined policies of a statute. (*Id*. at 10 n.2.) Despite the Court embarking, unprompted, on a river of curiosity about an issue it had uncovered during its

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[4] If one were to read plaintiffs' reply, it would seem to the reader that plaintiffs were attempting to raise a new claim or argument premised upon the public policy of denying deductions when the deductions are denied due to a "dead letter" law, which plaintiffs assert the Controlled Substances Act has become. (*See* ECF No. 54 at 1-6.) This might have been an interesting question. But, plaintiffs failed to raise it when they could have done so at any time during the parties' pre-Judgment briefing. The mere fact that this Court may have ruminated on a related issue does not give plaintiffs carte blanche to run amok with it. Moreover, plaintiffs' adoption of yet another new argument indicates that plaintiffs are presenting "theories seriatim" in an effort to avoid dismissal. *See Minter*, 451 F.3d at 1206 (quotation omitted).

own research, those ramblings had nothing to do with resolving the issue before the Court: plaintiffs' argument that the Constitution forbids including in gross income the cost of ordinary and necessary business expenses. (*See id*. at 10.) As the Court explained, plaintiffs provided no case law holding that argument to be true (*id*. at 10-11), and that lack of support has not changed despite plaintiffs' copious arguments in the motion to alter and reply. As a result, plaintiffs provide no sound reason for altering the Judgment on this basis.

III. Conclusion

For the reasons discussed herein, the Court DENIES the motion to alter or amend judgment (ECF No. 50).

SO ORDERED.

DATED this 28th day of April, 2017.

BY THE COURT:

/s/ Raymond P. Moore
RAYMOND P. MOORE
United States District Judge

UNITED STATES COURT OF APPEALS

FOR THE TENTH CIRCUIT

ALPENGLOW BOTANICALS, LLC, a Colorado Limited Liability Company, et al., Plaintiffs - Appellants, v. UNITED STATES OF AMERICA, Defendant - Appellee.	No. 17-1223

ORDER

(Filed Sep. 25, 2018)

Before **HARTZ**, **MURPHY**, and **McHUGH**, Circuit Judges.

Appellants' petition for rehearing is denied.

The petition for rehearing en banc was transmitted to all of the judges of the court who are in regular active service. As no member of the panel and no judge in regular active service on the court requested that the court be polled, that petition is also denied.

Entered for the Court

/s/ Elisabeth S. Shumaker

ELISABETH A. SHUMAKER, Clerk
