

9. Other Provisions

a. Disallowance of deductions relating to narcotics trafficking (sec. 351 of the Act and new sec. 280E of the Code)*

Prior Law

Ordinary and necessary trade or business expenses are generally deductible in computing taxable income. A recent U.S. Tax Court case allowed deductions for telephone, auto, and rental expenses incurred in the illegal drug trade. In that case, the Internal Revenue Service challenged the amount of the taxpayer's deduction for cost of goods (illegal drugs) sold, but did not challenge the principle that such amounts were deductible.

On public policy grounds, the Code makes certain otherwise ordinary and necessary expenses incurred in a trade or business nondeductible in computing taxable income. These nondeductible expenses include fines, illegal bribes and kickbacks, and certain other illegal payments.

Reasons for Change

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

Explanation of Provision

All deductions and credits for amounts paid or incurred in the illegal trafficking in drugs listed in the Controlled Substances Act are disallowed. To preclude possible challenges on constitutional grounds, the adjustment to gross receipts with respect to costs of goods sold is not affected by this provision of the Act.

Effective Date

The provision applies to amounts paid or incurred after the date of enactment in taxable years ending after that date.

*For legislative background of the provision, see: H.R. 4961, as reported by the Senate Finance Committee, sec. 391; S. Rep. No. 97-494, Vol. 1 (July 12, 1982), p. 300; and H. Rep. No. 97-760 (August 17, 1982), pp. 597-598 (Joint Explanatory Statement of the Committee of Conference).