

Businessman Sentenced for \$1M Medical Cannabis Tax Evasion

Ryan Richmond, the owner of Warren medical marijuana dispensary Relief Choices LLC, has been sentenced to 24 months in prison for tax evasion and obstructing an IRS investigation. The U.S. Department of Justice announced the sentencing on Wednesday.

Allegations of Tax Evasion

Federal authorities allege that Richmond paid operating expenses in cash and routed credit card payments through an unrelated third-party bank account to conceal the company's gross receipts, evading taxes amounting to \$1.1 million between 2011 and 2014. Richmond was found guilty in federal court in September.

Legal Gray Area for Relief Choices

Relief Choices operated in a legal gray area within the state of Michigan. Although voters passed the state's medical marijuana law in 2008, court battles persisted for years, and the first medical marijuana operating license wasn't issued until 2018. Legislators passed the regulatory framework in 2016, but the process took two years to implement. Consequently, Relief Choices operated outside the state's legal framework without facing enforcement from state authorities as the legal conundrum played out in the courts.

Cash-Only Operations

Federal authorities also allege that the business largely used cash. At the time, marijuana businesses were largely excluded from the banking market and were forced to use cash, a practice that continues to some extent today. Most marijuana businesses now bank with credit unions in the state that have accepted the risk of banking cannabis.

Tax Obligations for All Income

Under Section 61(a)(2) of the Internal Revenue Code, businesses are obligated to pay income taxes on all income derived from business operations, including from illegal sources. This standard was established in the 1961 case *James v. United States*, where Eugene James, a union official, did not report \$738,000 of embezzled income on his taxes. James faced restitution but not criminal liability for tax evasion.

Severe Penalties for Richmond

Richmond faces both prison time and restitution. In addition to his 24-month prison sentence, Richmond is ordered to pay \$2.8 million in restitution to the IRS, 2.5 times the amount of taxes due.

Failure to File Tax Returns

Richmond did not file a personal tax return in 2014, despite Relief Choices generating \$1.8 million in revenue. He also failed to report Relief Choices as a business he owned on his personal taxes between 2012 and 2014. This likely triggered the IRS audit in 2015 and 2016. Prosecutors allege that Richmond misled the IRS about his knowledge of, role in, and profits derived from Relief Choices.

Others Filed Tax Returns Despite Legal Uncertainty

Despite the legal gray area at the time, other operators in the state filed tax returns and reported income from quasi-illegal medical marijuana dispensaries. While federal authorities did not exert legal authority over most companies for selling federally illegal marijuana, the tax implications were significant and remain so today.

High Tax Rates for Cannabis Businesses

Because marijuana is federally classified as a Schedule I narcotic, operators, even legal ones, cannot deduct business operating expenses from gross income, leading to an effective tax rate as high as 75%. This code, Section 280E, was established after a 1974 case involving Jeffrey Edmondson, a drug dealer who successfully claimed business expenses for dealing drugs. Congress responded by enacting Section 280E the following year.

The federal government is currently working to reclassify marijuana as a Schedule II drug, which would eliminate Section 280E and create instant cash flow for dispensaries. This change could make tax evaders like Richmond more likely to pay taxes as the cost-benefit arithmetic changes.

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