Summary Analysis of Amended Bill

Author: Jones-Sawyer, et al.  Sponsor:  Bill Number: AB 1863
Analyst: Janet Jennings  Phone: (916) 845-3495  Amended: April 17, 2018
Attorney: Bruce Langston  Related Bills: See Prior Analysis

Subject:  Personal Income Tax Deduction Related to Commercial Cannabis Activities

Summary

This bill, under the Personal Income Tax Law (PITL), allow the deduction of ordinary and necessary business expenses attributable to a licensee’s commercial cannabis activity.

Recommendation – No position.

Summary of Amendments

The April 17, 2018, amendments added co-authors, and modified the operative date and eligibility for the deduction. As a result of the amendments, a new implementation consideration, technical consideration, and policy concern have been identified and the policy concern provided in the department’s analysis of the bill as introduced January 11, 2018, has been resolved. Except for the “Effective/Operative Date,” “This Bill,” “Implementation Considerations,” “Technical Considerations,” “Fiscal Impact,” “Economic Impact,” and “Policy Concerns” sections, the department’s analysis of the bill as introduced January 11, 2018, remains the same. The “Support/Opposition” section has been restated for convenience.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2018.

This Bill

This bill would under the PITL, allow a licensee under Division 10 of the Business and Professions Code to deduct ordinary and necessary business expenses related to a trade or business that is commercial cannabis activity, as defined in Division 10 of the Business and Professions Code.

Implementation Considerations

The department has identified the following implementation concern. Department staff is available to work with the author’s office to resolve this and other concerns that may be identified.
If this bill is enacted in late September or October of 2018, the department would have developed the forms and instructions for the 2018 taxable year. Thus, the department may incur additional costs to develop alternative forms and instructions in the short time frame necessary to ensure they are available for taxpayers to comply with the reporting requirement.

Technical Considerations

The terms “commercial cannabis activity” and “licensee” are both defined by reference to Division 10 of the Business and Professions Code. To eliminate the redundant reference and correct a grammatical error it is suggested that the wording be recast by striking lines 6 through 10, inclusive, and inserting:

not apply to the carrying on of any trade or business that is a commercial cannabis activity, by a licensee. For purposes of this section “commercial cannabis activity” and “licensee” shall have the same meaning as set forth in Division 10 (commencing with Section 26000) of the Business and Professions Code.

Fiscal Impact

If the bill is amended to resolve the implementation consideration addressed in this analysis, the department’s costs are expected to be minor.

Economic Impact

Revenue Estimate

This bill as amended April 17, 2018, would have a revenue impact on the general fund, but the amount is unknown.

Revenue Discussion

Absent the availability of Franchise Tax Board data, the department identified a review article issued by the University of California Agricultural Issues Centers (AIC) that examined six different studies on the cannabis market and its potential market size. The AIC review article indicated that the commercial cannabis activities market could be valued between $4 and $11 billion in California.

Although, the form of business ownership for tax years beginning on or after January 1, 2018, is unknown, for purposes of this estimate, it is assumed that these entities would operate under the PITL, e.g., a sole proprietorship or partnership. Using income and expense data in the AIC report, it is assumed that ordinary and necessary business expenses would be approximately 20 percent of sales. As a result, every $1 billion in retail market sales would result in an estimated additional $200 million in deductions claimed resulting in an estimated revenue loss of $13 million per $1 billion in PITL retail sales.
Policy Concerns

Unlike the Corporation Tax Law, which allows the deduction of ordinary and necessary business expenses of a commercial cannabis activity regardless of whether the taxpayer is a licensee, this bill would, under the PITL, limit deductibility to licensees, as defined. Thus, this bill could provide differing treatment based solely on a taxpayer’s form of organization.

Support/Opposition

Support: None provided.

Opposition: None provided.

Legislative Staff Contact

Janet Jennings
Legislative Analyst, FTB
(916) 845-3495
janet.jennings@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Diane Deatherage
Legislative Director, FTB
(916) 845-6333
diane.deatherage@ftb.ca.gov