STATE OF CALIFORNIA
Franchise Tax Board

Summary Analysis of Amended Bill

Author: Jones-Sawyer, et al.	Sponsor:	Bill Number: AB 1863
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Subject: Personal Income Tax Deduction Related to Commercial Cannabis Activities

Summary

This bill would, 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 May 8, 2018, amendments resolved the department's technical concern by updating a cross-reference as suggested in the department's analysis of the bill as amended April 17, 2018. Except for the "This Bill," and "Technical Concerns" sections, the department's analysis of the bill as amended April 17, 2018, remains the same. The "Fiscal Impact," "Economic Impact," and "Policy Concerns" sections are restated for convenience.

This Bill

This bill would, under the PITL, allow a licensee to deduct ordinary and necessary business expenses related to a trade or business that is a commercial cannabis activity. The bill would define "commercial cannabis activity" and "licensee" as having the same meanings as set forth in Division 10 (commencing with Section 26000) of the Business and Professions Code.

Fiscal Impact

This bill would not significantly impact the department's costs.

Economic Impact

Revenue Estimate

This bill as amended on May 8, 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 on a taxpayer's form of organization and licensee status.

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