STATE OF CALIFORNIA
Franchise Tax Board

Summary Analysis of Amended Bill

Author: Jones-Sawyer, et al.	Sponsor:	Bill Number: AB 37
Analyst: Cristina Perfino	Phone: (916) 845-4313	Amended: March 19, 2019
Attorney: Shane Hofeling	Related Bills: See Prior Analysis	

Subject: Personal Income Tax Deduction and Credits Related to Commercial Cannabis Activities

Summary

This bill would, under the Personal Income Tax Law (PITL), specify that the federal disallowance of tax expenditures related to the illegal sale of drugs would not apply to licensees engaged in the trade or business of commercial cannabis activities in the State.

Recommendation – No position.

Summary of Amendments

The March 19, 2019, amendments added a coauthor, a repeal date, and reporting requirements.

As a result of the March 19, 2019, amendments, several implementation concerns and a technical concern were identified. Except for the "Effective/Operative Date," "This Bill," "Implementation Considerations," "Technical Considerations," and "Fiscal Impact" sections, the remainder of the department's analysis of the bill as introduced on December 3, 2018, still applies. The "Economic Impact" section has been restated below 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, 2019, and before January 1, 2024.

This Bill

This bill would, under the PITL, for taxable years beginning on or after January 1, 2019, and before January 1, 2024, allow licensees engaged in commercial cannabis activity, to deduct expenses and claim tax credits, related to that trade or business.

"Commercial cannabis activity" and "licensee" would have the same meaning as specified in Section 26001 of the Business and Professions Code.

In uncodified law, this bill would require the Franchise Tax Board (FTB) to collect data relating to the number and total dollar amounts of deductions claimed by licensees engaged in commercial cannabis activity that are subject to the PITL.

Implementation Considerations

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The department would be required to collect data on the number and total dollar amount of deductions reported under the term of this bill. Collecting this data would require the department to change its systems, forms, and processes, which could be costly.

The bill is silent on when, how often, and to whom, the department would report the deduction information collected, as well as when the requirement to report would end.

Because the bill fails to specify otherwise, credits allowed under this bill would be excluded from the collection and reporting requirements.

Technical Considerations

For consistent use of terminology, Subparagraph C of the uncodified language needs to be amended where the term "make" appears, as it should be "claim."

The bill includes a reporting requirement for the FTB in uncodified law. For ease of reference, it is recommended the bill be amended to include these provisions within Section 17209 of the Revenue and Taxation Code.

Fiscal Impact

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This bill as amended on March 19, 2019, would have a revenue impact on the general fund, but the amount is unknown.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

Absent the availability of the FTB 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 billion and $11 billion in California.

Until taxpayers file their 2018 taxable year returns, the form of business ownership will remain 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.

In addition to expense deductions, this bill would allow commercial cannabis activities to claim tax credits. Because the amount and types of credits these business would claim is unknown, the additional revenue loss attributable to credits is unknown.

Legislative Staff Contact

Cristina Perfino
Legislative Analyst, FTB
(916) 845-4313
cristina.perfino@ftb.ca.gov

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

Jahna Carlson
Acting Legislative Director, FTB
(916) 845-5683
jahna.carlson@ftb.ca.gov