



## **Bill Analysis**

Author: Jones-Sawyer, et al. Bill Number: AB 37

**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.

### **Reason for the Bill**

The reason for the bill is to create taxpayer equality among taxpayers subject to the Corporation Tax Law (CTL) and the PITL by allowing otherwise allowable deductions and credits related to licensed commercial cannabis activities to taxpayers subject to the PITL.

### **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, 2020, and before January 1, 2025.

### **Federal/State Law**

Current federal and state laws generally allow taxpayers engaged in a trade or business to deduct expenses incurred conducting that trade or business.

Federal and state laws also provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Federal law states that no deduction or credit is allowed for any amount paid or incurred during the taxable year in carrying on any trade or business that consists of trafficking in specified controlled substances, including cannabis.

## State Law

The treatment of deductions and credits attributable to a trade or business that is commercial cannabis activities by a licensee under state law differs depending on whether the licensee is subject to the PITL or CTL.

### *Personal Income Tax Law Treatment*

The PITL conforms to federal law with respect to the treatment of amounts paid or incurred with respect to commercial cannabis activity in that no deduction or credit is allowed for any amount paid or incurred during the taxable year related to that activity.

### *Corporation Tax Law Treatment*

Under the CTL, a licensee engaged in commercial cannabis activity is allowed otherwise allowable deductions or credits assuming the entity has adequate records to substantiate these items.

## This Bill

This bill would, under the PITL, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, 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 and credits claimed by licensees engaged in commercial cannabis activity that are subject to the PITL.
- Report the required data to the Legislature on or before July 31 of each calendar year in which either the deductions or credits are allowed in compliance with Government Code (GC) section 9795.<sup>1</sup>

## Implementation Considerations

Because of the automatic extension that allows a timely filed return to be filed as late as October 15<sup>th</sup>, and the processing time for returns filed later than the April 15<sup>th</sup>

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<sup>1</sup> GC section 9795 generally specifies to whom reports to the Legislature must be provided and the required format.

original due date, the required reports may contain data for returns processed to date as opposed to all timely filed returns for a taxable year.

### **Legislative History**

AB 420 (Wood, et al., 2017/2018) and AB 1863 (Jones-Sawyer, et al., 2017/2018), both substantially similar to this bill, would have allowed a licensee subject to the PITL to deduct ordinary and necessary business expenses related to commercial cannabis activity, as well as to generally claim tax credits. AB 420 failed to pass out of the Senate by the constitutional deadline. AB 1863 was vetoed by the governor whose veto message stated in part, "Given the cost to the General Fund, this proposal is best evaluated as part of the budget process."

### **Other States' Information**

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable deduction or credit. These states were selected and reviewed due to their similarities to California's economy, business entity types, and tax laws.

### **Fiscal Impact**

Staff estimates a cost of approximately \$17,000 for fiscal year 2020-2021 and \$29,000 for fiscal years 2021-2022 and thereafter for resources required to capture return data to meet the bill's reporting requirement.

### **Economic Impact**

#### Revenue Estimate

This bill 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.

**Appointments**

None.

**Votes**

Location	Date	Yes Votes	No Votes
Concurrence	September 9, 2019	71	3
Assembly Floor	May 23, 2019	69	1
Senate Floor	September 4, 2019	33	5

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