STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Bradford

Sponsor:

Bill Number: SB 1293

Related Bills: See Legislative History

Amended: March 16, 2022

SUBJECT

Cannabis Equity Tax Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), for taxable years beginning on or after January 1, 2022, and before January 1, 2027, allow a credit to certain taxpayers for business expenses that the taxpayer could not deduct or claim as a credit under the federal income tax law.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 16, 2022, amendments added the provision discussed in this analysis below to the intent language.

This is the department’s first analysis of the bill.

REASON FOR THE BILL

The reason for this bill is to provide a credit to certain licensed cannabis businesses for the normal business expenses that they could not deduct or claim as a credit on their federal taxes.

ANALYSIS

This bill would, under the PITL and CTL, for taxable years beginning on or after January 1, 2022, and before January 1, 2027, allow a credit to a qualified taxpayer in an amount equal to the amount of business expenses of the taxpayer's trade or business that the taxpayer could not deduct or claim as a credit for that taxable year under the federal income taxes.

The bill defines a "qualified taxpayer," as an equity applicant or licensee that demonstrates all of the following:

- In local jurisdictions with equity programs, applicants must be local equity applicants or licensees. In local jurisdictions without equity programs, applicants must be local applicants or licensees.
- Individually or in combination with other equity applicants who qualify, own at least 50 percent of the business.
- They satisfy at least one of the following:
    - Have a prior arrest or conviction for past criminal justice policies related to cannabis prohibition.
    - Reside in a low-income household, as defined.
    - Reside in an area that has been disproportionately impacted by past criminal justice policies related to cannabis prohibition.
      The Department of Cannabis Control would provide the Franchise Tax Board (FTB) with a list of equity applicants and licensees, on January 1, 2023, and annually thereafter, for purposes of administering this credit.

This bill would provide an unlimited carryover period for excess credit amounts.

This credit would be repealed by its own terms on December 1, 2027.

For purposes of complying with Section 41 of the Revenue and Taxation Code (RTC), the FTB would be required to submit to the Legislature a report on or before July 31, 2023, and annually thereafter that includes the number of credits claimed and the total dollar amount of credits claimed.

The bill states that the disclosure provisions associated with the Section 41 requirements would be treated as an exception to general prohibition against disclosure applicable to FTB.

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, 2022, and before January 1, 2027.

Federal/State Law

Federal Law

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

Existing state and federal laws 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 hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Under the PITL, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, licensees engaged in commercial cannabis activity, as defined in the Business and Professions Code, may deduct expenses and claim tax credits, related to that trade or business.

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

Under RTC section 41, legislation that would create a new tax credit is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the credit.

Implementation Considerations

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

The bill requires the FTB to report information relating to the use of this credit under the RTC section 41 requirements. Because income tax returns for calendar year taxpayers may not be filed, with extension, until October 15th, the department would not have the data for the 2022 tax year until approximately June 2024. For clarity, it is suggested that the bill be amended to change the due date of the report to July 2024.

Technical Considerations

For technical consistency, the following change should be made, to clarify that the Section 41 reporting requirement will be in effect only while the credit is in effect.

- In section 4, subdivision (c), “while the credit is operative,” should be added after “and annually thereafter,”

In subdivision (a) of each provision, delete "under federal income taxes."

Section 17209 of the RTC, allows for licensees engaged in commercial cannabis activity, as defined in the Business and Professions Code, to deduct expenses and claim tax credits, related to that trade for taxable years beginning on or after January 1, 2020, and before January 1, 2025. If this bill is enacted, it would be effective through the 2026 tax year, which would require Section 17209 to be amended to expand the sunset date.

Policy Considerations

This bill does not limit the amount of the credit that may be taken. Credits that could potentially be quite costly are sometimes limited either on a per-project or per-taxpayer basis. This bill would provide a 100 percent credit, which would be unusual. Credits are generally allowed for percentages of expenses or in a specified amount versus dollar for dollar of the amount of deduction.

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Credits are generally enacted with a limited carryover period because experience shows credits typically are exhausted within eight years of being earned.

This bill would allow a credit for qualified expenditures that are currently deductible as business expenses at the state level. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense. Providing both a credit and allowing the full amount to be deducted would have the effect of providing a double benefit for that item.

LEGISLATIVE HISTORY

SB 603 (Bradford, 2021/2022) would, under the PITL and CTL, create a Cannabis Equity Business Tax Credit, related to licensing fees. SB 603 is currently pending in the Assembly Revenue and Taxation Committee.

SB 1336 (Wiener, 2021/2022) would, under the PITL and CTL, for taxable years beginning on or after January 1, 2022, and before an unspecified date, allow a credit to a qualified taxpayer equal to the amount of the qualified taxpayer's qualified expenditures in the taxable year limited to an unspecified dollar amount. SB 1336 is currently pending in the Senate Governance and Finance Committee.

AB 37 (Jones-Sawyer, Chapter 792, Statutes of 2019) under the PITL, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, allows licensees engaged in commercial cannabis activity, to deduct expenses and claim tax credits, related to that trade or business.

PROGRAM BACKGROUND

None noted.

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 Discussion

To determine the revenue impact of this bill, the number of equity applicants and licensees and the amount of business expenses the taxpayer would be unable to deduct or claim as a credit due to IRC Section 280E must be known. This information is not currently available. However, assuming the average amount of business expenses a qualified taxpayer would be unable to deduct or claim as a credit is $10,000, the estimated credits generated would be $10,000. It is estimated that for every 1,000 qualified taxpayers, total credits generated would be $10 million. It is assumed that 70 percent, or $7 million, would be earned by taxpayers with sufficient tax liability to offset with the credit. Of that amount, 65 percent, or approximately $4.5 million, would be claimed in the year generated and the remaining credits would be used over the subsequent years or until exhausted.

The revenue impact could increase or decrease dependent upon the amount of credits generated that could not be deducted or claimed as a credit for the taxable year on their federal return.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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