STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Committee on Budget	Sponsor:	Bill Number: AB 195
	Related Bills: See Legislative History	Amended: June 26, 2022

SUBJECT

Cannabis Tax Credits

SUMMARY

This bill would do the following:

Provision No. 1 - High Road Cannabis Tax Credit

This provision would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), for taxable years beginning on or after January 1, 2023, and before January 1, 2028, allow a credit to a qualified taxpayer equal to 25 percent of the qualified taxpayer's qualified expenditures in the taxable year, not to exceed $250,000.

Provision No. 2 - Cannabis Equity Tax Credit

This provision would, under the PITL and CTL, for taxable years beginning on or after January 1, 2023, and before January 1, 2028, allow a credit to a qualified taxpayer in an amount equal to $10,000.

RECOMMENDATION

None.

SUMMARY OF AMENDMENTS

The June 26, 2022, amendments removed intent language relating to the Budget Act of 2021, and replaced it with the provisions discussed in this analysis.

This is the department's first analysis of the bill and only addresses the provisions that impact the department's programs and operations.

REASON FOR THE BILL

The reason for this bill is to provide tax relief to cannabis businesses.

Effective/Operative Date

As provisions within a bill providing for appropriations relating to the Budget Bill, provisions 1 and 2 would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2023, and before January 1, 2028.

ANALYSIS

Analysis Provision No. 1:

High Road Cannabis Tax Credit (Sections 14, 16 and 38)

This provision would, under the PITL and CTL, for taxable years beginning on or after January 1, 2023, and before January 1, 2028, allow a credit to a qualified taxpayer equal to 25 percent of the qualified taxpayer's qualified expenditures in the taxable year, not to exceed $250,000.

The taxable year maximum of $250,000 would apply to the aggregate amount of credit claimed by all taxpayers that are required to or are authorized to be included in a combined report under Revenue and Taxation Code (RTC) section 25101 and RTC section 25101.15.

The provision defines the following terms:

"Full-time employee" means an individual who is either of the following:

- Paid wages subject to withholding under the Unemployment Insurance Code (UIC) by the qualified taxpayer for services not less than an average of 35 hours per week.
- A salaried employee who was paid compensation during the taxable year for full-time employment, as described in Section 515 of the Labor Code (LAB), which defines "full-time employment," as employment in which an employee is employed for 40 hours per week that is paid wages subject to withholding under the UIC.

"Qualified expenditures" means amounts paid or incurred by a qualified taxpayer for any of the following:

- Employment compensation for the employees of the qualified taxpayer. For the purposes of this provision, "employment compensation" means wages paid to full-time employees who are paid no less than 150 percent but no more than 350 percent of the applicable minimum wage. "Employment compensation" may include the monetary value to the full-time employee of health insurance benefits, childcare benefits, retirement benefits, or pension benefits.

- Safety-related equipment, training, and services. For purposes of this provision, "safety-related equipment, training, and services," means:
    - o Equipment primarily used by employees of cannabis licensees to ensure their personal and occupational safety or the safety of customers of the cannabis licensees;
    - o Training for nonmanagement employees on workplace hazards, including but not limited to, the Cal/OSHA (Division of Occupational Safety and Health) 30-hour training general industry outreach course as defined in Business and Professions Code (BPC) section 26051.5(a)(11)(A); and
    - o Services including, but not limited to, safety audits, security guards, security cameras, and fire risk mitigation.
- Workforce development for employees of the qualified taxpayer. For purposes of this provision, "workforce development" includes, but is not limited to, joint labor management training programs, membership in a joint apprenticeship training committee registered by the Division of Apprenticeship Standards, and a state-recognized high road training partnership, which is an initiative or project that models strategies for developing industry-based, worker-focused training partnerships, including labor-management partnerships.

"Qualified taxpayer" means a commercial cannabis business, licensed pursuant to Division 10 (commencing with Section 26000) of the BPC, related to cannabis, and who provides full-time employees with all of the following:

- Employment compensation as described in this provision.
- Employer-provided group health insurance.
- Employer-provided retirement benefits, including stock in the duly licensed commercial cannabis employer to employees under employee stock ownership plans where the employers pays for the full value of the stock.
- Possess a Retailer or Microbusiness cannabis license pursuant to Section 26050 of the BPC.

To be eligible for this credit, a qualified taxpayer would be required to obtain a tentative credit reservation from the Franchise Tax Board (FTB), in the form and manner prescribed by the FTB, during the month of July for each taxable year or within 30 days of the start of their taxable year if the qualified taxpayer's taxable year begins after July.

To get a reservation with respect to a qualified expenditure, the qualified taxpayer would be required to provide all necessary information as determined by the FTB. The FTB would be required to approve tentative credit reservations for qualified expenditures incurred during the taxable year for the qualified taxpayers, subject to the credit cap.

A total aggregate amount of $20,000,000 for all taxable years, cumulatively, may be allocated by credit reservations for this credit.

This provision specifies that any deduction or credit otherwise allowed for any qualified expenditure made by the qualified taxpayer as a trade or business expense must be reduced by the amount of this credit.

The FTB may prescribe rules, guidelines or procedures necessary or appropriate to administer this credit. Chapter 3.5 of the Government Code, related to Administrative Regulations and Rulemaking shall not apply to the FTB for purposes of this credit.

Unused credits may be carried over for eight years until the credit is exhausted.

The provision would remain in effect only until December 1, 2028, and as of that date would be repealed.

For purposes of complying with RTC section 41, the specific goals and purposes and objectives the credit will achieve are as follows (Section 38):

- Provide relief for high road cannabis employers who are providing good jobs in a struggling industry.
- Assist high road cannabis employers and operators to say in business or grow their business.

To determine whether the credit meets the goals and purposes, the FTB would be required to furnish a report to the Legislature, on or before March 1, 2025, and annually thereafter while the credit is operative, which shall include the number of credits claimed and the total dollar amount of credit claimed.

The Section 41 provision would be treated as an exception to the disclosure provision in Section 19542 of the RTC.

*Federal/State Law (**All Provisions**)*

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 deductions or credits that are otherwise allowable, 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 (**All Provisions**)*

None noted.

*Technical Considerations (**All Provisions**)*

None noted.

*Policy Considerations (**All Provisions**)*

None noted.

LEGISLATIVE HISTORY (All Provisions)

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 1293 (Bradford, 2021/2022), similar to this provision, would under the PITL and CTL, for taxable years beginning on or after January 1, 2022, and before January 1, 2027, allow a Cannabis Equity Tax Credit to qualified taxpayers. SB 1293 is currently in the Assembly Appropriations 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 (All Provisions)

None noted.

FISCAL IMPACT

Staff estimates a cost of approximately $143,000 for fiscal year 2022/2023 to build the reservation system, and $609,000 for fiscal year 2023/2024 for updates to operational expenses, and updates to information technology.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 195 as Amended on June 26, 2022
Assumed Enactment after June 30, 2022

($ in Millions)

Fiscal Year	Revenue
2022-2023	-$3.1
2023-2024	-$5.5
2024-2025	-$2.9

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

Based on cannabis industry research, it is estimated that qualified taxpayers would pay $170 million in employment compensation to qualified employees in the 2023 taxable year. This amount was then increased for expenditures on safety-related equipment, training, and services and workforce development and safety training. This results in total qualified expenditures of $230 million for taxable year 2023. After applying the 25 percent credit and the $250,000 per taxpayer credit limit, it is expected the maximum credit of $20 million would be generated in the 2023 taxable year.

It is estimated that approximately 85 percent, including the S corporation adjustment, or $18 million, would be earned by taxpayers with sufficient tax liability to offset with the credit. Of that amount 50 percent, or $9 million, would be claimed in the year generated and the remaining credit would be used over the subsequent eight years.

To arrive at the offsetting tax effect of expense deductions that would otherwise be allowed under current law, it is estimated that qualified taxpayers would be able to deduct approximately $22 million in qualified expenditures in taxable year 2023. Applying an average tax rate of 7 percent, results in an offsetting revenue gain of $1.5 million. The resulting net revenue loss, for taxable year 2023, would be approximately $7.5 million.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table.

LEGAL IMPACT (All Provisions)

None noted.

Analysis Provision No. 2:

Cannabis Equity Tax Credit (Sections 15, 17 and 39)

This provision would, under the PITL and CTL, for taxable years beginning on or after January 1, 2023, and before January 1, 2028, allow a credit to a qualified taxpayer in an amount equal to $10,000.

The provision defines a "qualified taxpayer," as an equity applicant or licensee eligible for the fee waiver and deferral program established, pursuant to Section 26249 of the Business and Professions Code, as administered by the Department of Cannabis Control (DCC).

The DCC would be required to provide the FTB with a list of equity applicants and licensees eligible for the fee waiver and deferral program, on January 1, 2024, and every six months thereafter, for purposes of administering this credit. The DCC may meet this requirement by maintaining a database that would make available this information to the FTB.

Unused credits could be carried over for eight years until exhausted.

The FTB may prescribe rules, guidelines or procedures necessary or appropriate to administer this credit. Chapter 3.5 of the Government Code, related to Administrative Regulations and Rulemaking shall not apply to the FTB for purposes of this credit.

This credit would be repealed by its own terms on December 1, 2028.

For purposes of complying with Section 41 of the RTC, the FTB would be required to submit to the Legislature a report on or before March 1, 2025, and annually thereafter while the credit is operative. The report would analyze the number of credits claimed and the total dollar amount of credits claimed.

The provision 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.

For purposes of complying with RTC section 41, the specific goals and purposes and objectives the credit will achieve are as follows (Section 39):

- Provide relief for individuals who are low income or who have directly or indirectly been negatively impacted by past cannabis policies.
- Assist cannabis equity licensees to stay in business or grow their business.

To determine whether the credit meets the goals and purposes, the FTB would be required to furnish a report to the Legislature, on or before March 1, 2025, and annually thereafter while the credit is operative, which shall include the number of credits claimed and the total dollar amount of credit claimed.

The Section 41 provision would be treated as an exception to the disclosure provision in Section 19542 of the RTC.

FISCAL IMPACT

Staff estimates a cost of approximately $609,000 for fiscal year 2023/2024 for updates operational expenses, and updates to information technology.

ECONOMIC IMPACT

Revenue Discussion

To determine the revenue impact of this proposal, the number of equity applicants and licensees must be known. Currently, the number of these qualified taxpayers is unknown. It is estimated for every 2,000 qualified taxpayers, the total credits generated would be $20 million. It is assumed that 70 percent, or $14 million, would be earned by taxpayers with sufficient tax liability to offset with the credit. Of that amount, 65 percent, or approximately $9.1 million, would be claimed in the year generated and the remaining credits would be used over the subsequent years or until exhausted.

APPOINTMENTS (All Provisions)

None noted.

SUPPORT/OPPOSITION (All Provisions)

Support

None on file.

Opposition

None on file.

ARGUMENTS (All Provisions)

None on file.

LEGISLATIVE CONTACT

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