STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Bradford

Sponsor:

Bill Number: SB 603

Related Bills: See Legislative History

Amended: March 10, 2021

SUBJECT

Cannabis Equity Business Tax Credit

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would create a Cannabis Equity Business Tax Credit.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 10, 2021, amendments removed provisions of the bill related to the Business and Professions Code (BPC) and replaced them with the provisions discussed in this analysis.

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

REASON FOR THE BILL

The reason for this bill is to provide a qualified taxpayer with a credit related to cannabis licensing fees.

ANALYSIS

This bill would, under the PITL, for taxable years beginning on or after January 1, 2021, allow a qualified taxpayer a credit, in an amount equal to state and local cannabis licensing fees paid by the qualified taxpayer.

A "qualified taxpayer" means either a local equity applicant or local equity licensee as defined in Section 26240 of the BPC:

- A "Local equity applicant" means an applicant who has submitted, or will submit, an application to a local jurisdiction to engage in commercial cannabis activity as specified.
- A "Local equity licensee" means a person who has obtained a license from a local jurisdiction to engage in commercial cannabis activity as specified.

Unused credits could be carried over for the following taxable years or until exhausted.

The bill specifies that it is the intent of the Legislature to comply with Section 41 of the Revenue and Taxation Code (RTC).

Effective/Operative Date

This bill would be effective January 1, 2022, and the credit would be specifically operative for taxable years beginning on or after January 1, 2021.

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.

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 BPC, may deduct expenses and claim tax credits, related to that trade or business.

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

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Considerations

For consistency with similar provisions of the RTC, on page 4, line 9, insert "or incurred, for the taxable year" after "fees paid."

Policy Considerations

This bill lacks a sunset date, which is generally provided to allow periodic review of the effectiveness of income tax law changes by the Legislature.

Generally, credits are limited as a percentage of amounts paid or incurred. This bill would allow a credit that lacks an economic outlay requirement, which is unusual.

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 provide a tax benefit for sole proprietorships, noncorporate partners of partnerships, limited partnerships, and limited liability companies not electing to be taxed as corporations, and limited liability partnerships under the PITL that would not be provided to other business entities such as corporations. Thus, this bill would provide differing treatment based solely on classification.

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 credit's effectiveness. While this bill states that it intends to comply with section 41, it does not include the required information to evaluate the credit's effectiveness.

LEGISLATIVE HISTORY

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 Estimate

This bill would apply to qualified taxpayers who are local equity applicants or local equity licensees, who meet the requirements of their jurisdictions' local equity program, a credit for cannabis licensing fees paid. To determine the revenue impact of this bill, the number of equity applicants and licensees must be known. Since this information is not available, it is estimated that for every 1,000 qualified taxpayers that file under the PITL and applying an average licensing fee of $17,000, the total credits generated would be $17 million. It is assumed that 60 percent, or $10 million, would be earned by taxpayers with sufficient tax liability to offset with the credit. Of that amount, 70 percent, or $7 million, would be claimed in the year generated and the remaining credits would be used over the subsequent six years.

The cost of licensing fees are dependent on the type of license(s) a qualified taxpayer would need for their business and what commercial cannabis activities they plan to engage in. These license fees are based on the applicant's or licensee's estimated gross revenue for annual license. Therefore, the revenue impact could increase or decrease depending on the amount paid for licensing fees.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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