Calif. Gov. Vetoes Tax Deduction for Pot Biz Expenses

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James Nani
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California Gov. Jerry Brown vetoed on Wednesday a bill that would have provided deductions for business expenses for a cannabis trade or business through the state's personal income tax law, decoupling the state tax code from the federal law barring tax breaks for trafficking in controlled substances.

In the veto message issued for Assembly Bill 1863, Brown said the bill, which would have become effective beginning with the 2018 tax year, seeks to apply state tax treatment to licensed cannabis businesses "regardless of whether they organize under the personal income tax or corporate income tax."

"Given the cost to the general fund, this proposal is best evaluated as part of the budget process," Brown said.

A fiscal analysis done by a state Senate committee in August cited the state's Franchise Tax Board, which said the revenue loss resulting from the bill was indeterminable, "because it lacks the historical data required to develop a reliable estimate."

However, the board research staff also cited a review article issued by the University of California Agricultural Issues Centers that examined six different studies on the cannabis market and its potential market size, which said the retail cannabis market in the state could be valued between $4 billion and $11 billion. Assuming that applicable business expenses are 20 percent of sales, every $1 billion in retail sales would result in an additional $200 million in deductions and at a 6 percent tax rate the revenue loss would be $13 million per $1 billion of retail sales, that research found.

The bill, introduced on Jan. 11 and sponsored by Assemblyman Reginald Jones-Sawyer, D-Los Angeles, would have allowed for deductions for each taxable year beginning after last Dec. 31.

Under federal law, deductions or credits aren't allowed for business expenses if the trade consists of trafficking in controlled substances prohibited by state or federal law, such as the federal Controlled Substances Act.

According to the bill's author, the cannabis industry has multiple barriers to entry that include limited access to banking, compliance with state regulations, a high tax burden and continuing threats by the federal government to treat the state-legalized marijuana industry as a criminal activity.

While Section 280E of the Internal Revenue Code prohibits cannabis businesses from deducting ordinary business expenses from their federal taxes, the bill would have decoupled state tax code from that part of the federal code and allowed cannabis businesses to be taxed in the same manner as businesses in other industries for the purpose of state taxes.

The bill was supported by the California Cannabis Industry Association, the Rural County Representatives of California and the Urban Counties of California.

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