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California laws passed in 2019 and the codes they modified



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AB 37: State tax deductions for cannabis businesses

By Lysondra Ludwig

For tax years beginning on or after Jan. 1, 2020 and before Jan. 1, 2025, California's legal cannabis businesses subject to the state's personal income tax (i.e. an entity taxed as a pass through) will be able to claim tax deductions or credits on their California state tax return. Previously, businesses subject to the state's personal income tax were taxed in conformity with federal law. Federal law disallows cannabis businesses to deduct a wide

array of ordinary and necessary business expenses related to a trade or business whose activities consist of trafficking specified controlled substances, such as cannabis, under Section 280E of the Internal Revenue Code. However, in California, cannabis businesses organized as C-corporations for tax purposes are allowed such deductions with respect to their California tax returns, effectively providing a tax incentive to organize a cannabis business as a C-corporation.

In an effort to level the

tax playing field, Assembly-member Reggie Jones-Sawyer's (D-South Los Angeles) proposed Assembly Bill 37, which exempts legal California cannabis businesses licensed under the Medicinal and Adult-Use Cannabis Regulation and Safety Act from Section 280E under the Internal Revenue Code. Accordingly, legal cannabis business subject to personal income tax, such as sole proprietorships or partnerships, will be treated the same as businesses organized as C-corporations.

Accordingly, other factors will drive the choice of entity decisions when organizing and operating a cannabis business in California.

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