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Good Tax News for the Cannabis Industry: California Repeals 280E Limitation for Personal Income Tax

by Jonathan S. Storper

Existing law, the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA), among other things, consolidates the licensure and regulation of commercial medicinal and adult-use cannabis activities and authorizes persons to conduct specified commercial cannabis activities, as defined, in the state.

The objectives of the new law are as follows:

1. To provide tax equity to the cannabis industry.
2. To exempt commercial cannabis activity by a licensee from Section 280E of the Internal Revenue Code, relating to expenditures in connection with the illegal sale of drugs, in order to allow cannabis businesses to claim deductions and credits available to other legal businesses in the state.
3. To provide commercial cannabis licensees the ability to claim ordinary business deductions from taxable income in the same manner that other state businesses do for state purposes.
4. To align the Personal Income Tax Law with the Corporation Tax Law in relation to deductions under Section 280E of the Internal Revenue Code.

The Personal Income Tax Law and the Corporation Tax Law allow various deductions in computing the income that is subject to the taxes imposed by those laws. The Personal Income Tax Law conforms as of a specified date to federal income tax laws with respect to itemized deductions, including business deductions and items not deductible, except as specifically provided. The Corporation Tax Law does not conform to those federal income tax provisions, but specifically provides for deductions for purposes of that law.

Existing federal income tax laws disallow a deduction or credit for business expenses of a trade or business whose activities consist of trafficking specified controlled substances, including marijuana. This is known as the section 280E disallowance section of the internal revenue code. The Personal Income Tax Law conforms to those federal income tax law provisions with respect to deductions.

The new law, for each taxable year beginning on or after January 1, 2020, and before January 1, 2025, would specifically provide in the Personal Income Tax Law for nonconformity to that federal law disallowing a deduction or credit for business expenses of a trade or business whose activities consist of trafficking specified controlled substances only for commercial cannabis activity, as defined under MAUCRSA, by a licensee under MAUCRSA, thus allowing deduction of business expenses paid or incurred during the taxable year in carrying on that commercial cannabis activity under the Personal Income Tax Law.

This new law takes effect immediately.

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