RESOLUTION 01-02-2018

DIGEST
Revenue and Taxation: Sole Proprietorship Deductions
Amends Revenue and Taxation Code section 17201 to allow a sole proprietor in the marijuana business to deduct operating expenses.

TEXT OF RESOLUTION

RESOLVED that the Conference of California Bar Associations recommends that legislation be sponsored to amend Revenue and Taxation Code section 17201 as follows:

§ 17201

(a) Part VI of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to itemized deductions for individuals and corporations, shall apply, except as otherwise provided.

(b) Part VII of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to additional itemized deductions for individuals, shall apply, except as otherwise provided.

(c) Part IX of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to items not deductible, shall apply, except as otherwise provided. Internal Revenue Code Section 280E is specifically excluded.

(Proposed new language underlined; language to be deleted stricken)

PROPONENT: Contra Costa County Bar Association

STATEMENT OF REASONS

The Problem: Existing law allows a cannabis or marijuana business that is a corporation to deduct non-operating expenses because California corporate law does not conform to Internal Revenue Code (IRC) Section 280E. California Revenue and Tax Code (CRTC) § 17201, however, conforms to IRC §280E. Under current law, a corporation in the marijuana/cannabis industry can deduct operating expenses, but sole proprietorships cannot.

The Solution: This resolution would make the treatment of corporations and sole proprietorships equal with respect to being able to deduct operating expenses.

IMPACT STATEMENT
This resolution does not affect any other law, statute or rule other than those expressly identified.

CURRENT OR PRIOR RELATED LEGISLATION
None known.

AUTHOR AND/OR PERMANENT CONTACT: Christina Weed, Weed Law, PC, 1655 N. Main Street, Suite 240, Walnut Creek, CA 94596, Phone: (925) 390-3270, cweed@weedlawpc.com.

RESPONSIBLE FLOOR DELEGATE: Christina Weed

* * * * * *

RESOLUTIONS COMMITTEE RECOMMENDATION:
APPROVE IN PRINCIPLE

History:
No similar resolutions found.

Reasons:
This resolution amends Revenue and Taxation Code section 17201 to allow a sole proprietor in the marijuana business to deduct operating expenses. This resolution should be approved in principle because it would allow sole proprietorships in the marijuana/cannabis industry to be able to deduct operating expenses, as is already allowed for a corporation but not a sole proprietorship.

Revenue and Taxation Code section 17201, subdivision (c), expressly provides that "Part IX of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code" applies to *personal income tax* for determining what items are not deductible. Included in that part of Part IX of the Internal Revenue Code (IRC) is section 280E. That section provides that no deduction or credit shall be allowed for any amount paid or incurred for any trade or business that consists of trafficking in "controlled substances" which is prohibited by federal law. Section 280E further defines "controlled substances" as substances "within the meaning of schedule I and II of the Controlled Substances Act." Marijuana is a controlled substance prohibited by Federal law. (21 U.S.C. § 812, subd. (c).) Therefore, an individual cannot deduct operating expenses related to their marijuana business.

However, Revenue and Taxation Code section 24343, governing deductions for *corporations*, provides that "Section 162 of the Internal Revenue Code" applies. IRC section 162 lists "the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business" which are included as allowed deductions. Revenue and Taxation Code section 24343 does not reference IRC section 280E and IRC section 162 does not list controlled substances as items which are not deductible. Consequently, under California law, a corporation may deduct operating expenses related to its marijuana business.

Since it is legal to operate a marijuana business in California as an entity or an individual, both types of business owners should be treated equally with regards to authorized business deductions. The resolution corrects an undue disparity in such treatment. However, because IRC section 280E is not limited to marijuana/cannabis, and refers to all controlled substances, including IRC section 280E in its entirety could have the unintended consequence of allowing deductions for an individual's illegal drug business in California as well.