

DEPARTMENT OF TAXATION

2022 Fiscal Impact Statement

1. **Patron** Jeffrey L. Campbell

3. **Committee** House Finance

4. **Title** Income Tax; Marijuana Business Expenses.

2. **Bill Number** HB 1202

House of Origin:

X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would permit taxpayers to claim deductions and credits for reasonable and necessary business expenditures made in connection with carrying on a business licensed in Virginia to deal in recreational or medical marijuana. For federal income tax purposes, taxpayers are generally not permitted to deduct or claim credits with respect to any business expenses incurred in the production, distribution, and sale of marijuana.

This bill would be effective for taxable years beginning on and after January 1, 2022.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

8. **Fiscal implications:**

Administrative Costs

The Department of Taxation considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have an unknown negative General Fund revenue impact beginning in Fiscal Year 2023. It is unknown to what extent marijuana businesses operating in Virginia have business expenses that are subject to the federal prohibition on claiming such expenses on income tax returns.

9. **Specific agency or political subdivisions affected:**

Department of Taxation

10. Technical amendment necessary: Yes.

As currently drafted, this bill would deconform from the federal prohibition on claiming deductions and credits with respect to marijuana business expenses. Unless otherwise prohibited, Virginia businesses may claim federal income tax deductions on their state returns. In contrast, Virginia taxpayers may not claim federal income tax credits on their state returns. Therefore, the portion of this bill that references credits does not provide any benefit to taxpayers and the Department recommends the following technical amendment:

Page 1, Line 56, after deductions
Strike: or credits

It is our understanding that this bill is intended to permit businesses in the marijuana industry to claim the federal deduction for ordinary and necessary business expenses incurred in carrying on a trade or business on their Virginia return. Therefore, the Department recommends the following technical amendment to align the tax benefit this bill would provide with the relevant federal deduction:

Page 1, Line 56, after credits for
Strike: reasonable
Insert: ordinary

11. Other comments:

Federal Tax Law and Marijuana Business Expenses

Federal law generally prohibits tax deductions and credits for any amount paid or incurred during the taxable year in carrying on a trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking controlled substances that is prohibited by federal law or the law of any State in which such trade or business is conducted. This prohibition includes businesses related to the trafficking of marijuana. Marijuana business owners are allowed to deduct their cost of goods sold, which essentially includes the cost of their inventory. This prohibition for federal income tax purposes applies regardless of whether the state in which the business is operated has legalized marijuana for recreational and other purposes.

Marijuana Business Expenses and Other States

As of February 2022, 33 states and the District of Columbia have legalized medical marijuana in some form. Of those, 18 states and the District of Columbia have also legalized recreational marijuana. Seven states (Colorado, Hawaii, Maine, Michigan, Minnesota, Montana, and Oregon) have enacted legislation that to permits taxpayers to claim deductions and credits with respect to marijuana business expenses on state income tax returns.

Proposed Legislation

This bill would permit taxpayers to claim deductions and credits for reasonable and necessary business expenditures made in connection with carrying on a business licensed in Virginia to deal in recreational or medical marijuana. For federal income tax purposes, taxpayers are generally not permitted to deduct or claim credits with respect to any business expenses incurred in the production, distribution, and sale of marijuana.

This bill would be effective for taxable years beginning on and after January 1, 2022.

cc : Secretary of Finance

Date: 2/6/2022 JLOF
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