F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 2/7/18
SPONSOR Ortiz y Pino **LAST UPDATED** **HB**

SHORT TITLE Deduction Of Certain Business Expenses **SB** 228

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY18	FY19	FY20	FY21	FY22		
--	(negative but likely small)				Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 228 amends the definitions in the Income Tax Act and the Corporate Income and Franchise Act for base income to allow a deduction for business expenditures that have been disallowed for federal income tax purposes by Section 280E of the Internal Revenue Code (IRC). IRC Section 280E prevents businesses trafficking in controlled substances from deducting otherwise ordinary business expenses from gross income. Decoupling Section 280E from the state's personal income tax (PIT) and corporate income tax (CIT) regimes would allow state-legal medical cannabis businesses to deduct ordinary business expenses from their gross income for the purpose of determining state tax liability.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends. The provisions of this bill apply to tax years beginning on or after January 1, 2018.

FISCAL IMPLICATIONS

The Taxation and Revenue Department (TRD) and LFC staff are unable to generate a fiscal estimate for this bill due to lack of sufficient data. Because this bill would allow for deduction of business expenses from gross income, it will reduce the state tax liability of legal medical cannabis businesses and therefore result in a negative fiscal impact to the general fund. However, due to the relatively small size of the medical cannabis industry in the state, the impact is likely to be small, although it could grow over time as the industry grows. Currently there are about 35 producers participating in the state's Medical Cannabis Program.

SIGNIFICANT ISSUES

Currently, New Mexico's legal medical cannabis businesses cannot avail themselves of deductions available to other state taxpayers. Ordinarily, firms engaging in legal business in this state are able to deduct business expenses from their gross income for the purpose of determining state tax liability. However, because New Mexico's income taxes piggyback the federal IRC, and because cannabis is a controlled substance, duly licensed medical cannabis businesses in New Mexico cannot deduct legal business or trade expenses in a manner similar to other taxpayers in the state. This bill appears to address this issue and therefore seems meet the LFC tax policy principle of equity, which holds that different taxpayers should be treated fairly.

New Mexico is one of 25 states that allow the use of cannabis by individuals with certain qualifying medical conditions. The Compassionate Use Medical Marijuana Act, enacted in 2007, permits the use of cannabis by New Mexico residents with certain severe medical conditions and establishes the broad regulatory framework for the state's Medical Cannabis Program.

ADMINISTRATIVE IMPLICATIONS

TRD indicates this bill is an example of "decoupling" from federal income tax rules for state tax purposes. Implementation will require audit and revenue processing staff commitments.

TECHNICAL ISSUES

According to TRD, "there exist legal tax strategies for businesses engaged in the legal cannabis industry to circumvent the restrictions imposed by this section of the IRC. Taxation of the marijuana industry is complicated and complex. Amending these sections of New Mexico law may result in unintended consequences, and may be unnecessary as legal options exist without the proposed changes."

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

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