

**FINAL  
FISCAL NOTE**

**Drafting Number:** LLS 13-0627  
**Prime Sponsor(s):** Rep. Kagan  
 Sen. Guzman

**Date:** July 3, 2013  
**Bill Status:** Signed into Law  
**Fiscal Analyst:** Clare Pramuk (303-866-2677)

**TITLE:** CONCERNING A STATE INCOME TAX DEDUCTION FOR A TAXPAYER WHO IS PROHIBITED FROM CLAIMING A FEDERAL INCOME TAX DEDUCTION BY SECTION 280E OF THE INTERNAL REVENUE CODE BECAUSE MARIJUANA IS A CONTROLLED SUBSTANCE UNDER FEDERAL LAW, AND, IN CONNECTION THEREWITH, MAKING AN APPROPRIATION.

<b>Fiscal Impact Summary</b>	<b>FY 2013-2014</b>	<b>FY 2014-2015</b>	<b>FY 2015-2016</b>
<b>State Revenue</b> General Fund	(\$829,000)	(\$1,658,000)	(\$1,658,000)
<b>State Expenditures</b> General Fund	\$280,000		\$57,333
<b>FTE Position Change</b>			1.2 FTE
<b>Effective Date:</b> The bill was signed into law by the Governor on May 28, 2013, and takes effect August 7, 2013, assuming no referendum petition is filed. Applies to income tax years commencing on or after January 1, 2014.			
<b>Appropriation Summary for FY 2013-2014:</b> See State Appropriations section.			
<b>Local Government Impact:</b> None.			

**Summary of Legislation**

Under current law, the starting point for determining state income tax liability is federal taxable income. There is no place on the Colorado tax form to deduct expenses that are included on the federal form. Under Section 280E of the Internal Revenue Code, expenses associated with the trade or business of trafficking in illegal controlled substances are disallowed. Because marijuana is classified as a Schedule 1 controlled substance under the Federal Controlled Substances Act, medical marijuana businesses are unable to deduct expenses related to the actual transfer of goods from the business to the patient.

Beginning with tax year 2014, this bill allows state-licensed medical marijuana businesses to claim a state income tax deduction for business expenses that are otherwise eligible to be claimed as a federal income tax deduction but are disallowed by Section 280E of the Internal Revenue Code, such as rent and personnel costs. These amounts are currently taxed at a state rate of 4.63 percent. Expenses for business start up and the cost of goods are allowed to be deducted. Businesses that will operate under Amendment 64 are not included in the bill.

## **Background**

The use of medical marijuana by patients with qualifying medical conditions was approved by voters in 2000, followed in 2012 by voter approval of possession of small amounts of recreational marijuana. Both the use and possession of marijuana remain illegal under federal law. The medical marijuana industry has been in existence in Colorado since 2009 and has an annual income of about \$200 million. State law requires marijuana businesses to be licensed by both state and local authorities. With the passage of Amendment 64, the future of the medical marijuana market is in question. The issue of income tax deductions for businesses engaged in the sale of recreational marijuana is being considered by a state task force.

## **State Revenue**

**This bill is estimated to reduce General Fund revenue by approximately \$829,000 in FY 2013-14 and \$1,658,000 in FY 2014-15 and thereafter.** To make this estimation and avoid the uncertainty of the future of the medical marijuana market, the fiscal note uses medical marijuana sales figures for tax year 2011. Because business expense data for medical marijuana businesses are not collected from tax returns, deductible expenses of approximately 18 percent of sales for liquor stores were used as a proxy for medical marijuana businesses. This percentage may be lower if medical marijuana businesses provide other goods or services and minimize the percentage of their operations dedicated to the actual delivery of medical marijuana to the patient.

## **State Expenditures**

**This bill is expected to increase General Fund expenditures by \$280,000 in FY 2013-14, and \$57,333 and 1.2 FTE in FY 2015-16, for the Taxation Division of the Department of Revenue.** No expenditures are required for FY 2014-15.

To enable medical marijuana businesses to deduct their business expenses on the state income tax form, the division will create a new schedule specific to this industry and for each of four types of tax returns. The state's tax processing software will be updated to accept and process new deductions. This is expected to be completed in FY 2013-14 at a cost of \$280,000.

Beginning in FY 2015-16, because these deductions are disallowed at the federal level, the division will be wholly responsible for auditing the accuracy of deductions taken on the new schedule. Agency staff will review tax filings for approximately 500 medical marijuana businesses to determine if the deductions are valid. The division is expected to review all 500 businesses within four years of implementing the new schedule. Review is expected to require 20 hours per account and an additional 1.2 FTE. These costs are shown in Table 1.

<b>Table 1. Expenditures Under HB13-1042</b>			
<b>Cost Components</b>	<b>FY 2013-14</b>	<b>FY 2014-15</b>	<b>FY 2015-16</b>
Personal Services			\$51,490
FTE			1.2
Operating Expenses and Capital Outlay			5,843
Computer Programming	\$280,000		
<b>TOTAL</b>	<b>\$280,000</b>		<b>\$57,333</b>

**Expenditures Not Included**

Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. The centrally appropriated costs subject to this policy are summarized in Table 2.

<b>Table 2. Expenditures Not Included Under HB13-1042*</b>			
<b>Cost Components</b>	<b>FY 2013-14</b>	<b>FY 2014-15</b>	<b>FY 2015-16</b>
Employee Insurance (Health, Life, Dental, and Short-term Disability)			\$8,037
Supplemental Employee Retirement Payments			3,991
<b>TOTAL</b>			<b>\$12,028</b>

*\*More information is available at: <http://colorado.gov/fiscalnotes>*

**State Appropriations**

For FY 2013-14, the Department of Revenue requires a General Fund appropriation of \$280,000.

**Departments Contacted**

Law                      Revenue