

NEW YORK GOVERNOR'S MARIJUANA LEGALIZATION PROPOSAL WOULD CREATE THREE NEW TAXES

By: Ariele Doolittle
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Earlier this week Governor Andrew Cuomo released the Executive Budget for the 2019-20 fiscal year, which includes a proposal for a new Cannabis Regulation and Taxation Act. High points of the Act include provisions to legalize adult-use of marijuana along with the availability of hemp products, and to expand the State's current medical marijuana program. From all of this, the budget forecasts revenue increases of \$83 million in fiscal year 2021, which is expected to increase to \$184 million in fiscal year 2024.[1]

If enacted, the Cannabis Regulation and Taxation Act may present an array of business opportunities, especially in the “adult use” space. The Act calls for creating a three-tier market structure—similar to what is already in place for alcohol—consisting of producers, wholesale distributors, and retail dispensaries. The basic structure of the three-tier system would be that producers can only sell their products to wholesale distributors, who in turn sell only to retailers, and only retailers may sell to end-users. The Act would also prohibit vertical integration and would impose licensing limits and supply management to control market concentration.

The legislation would also add a new article to the Tax Law—Article 20-C, titled “Tax on Adult-Use Cannabis Products”—which would impose three new taxes. First, a tax on the producer on the cultivation of cannabis at the rate of \$1 per “dry-weight gram of cannabis flower” and \$0.25 per “dry-weight gram of cannabis trim.”[2] Second, a state-level tax on the sale by a wholesaler to a retail dispensary at the rate of 20% of the invoice price.[3] And third, a county-level tax on the sale by a wholesaler to a retail dispensary at the rate of 2% of the invoice price.[4] In addition, all wholesalers would be required to apply for and obtain a Certificate of Registration from the New York State Tax Department before starting business and the registration would be renewable every two years. The initial application and renewal would be subject to a fee of \$600.[5]

As noted, there are also provisions for legalizing and expanding the availability of hemp products within the State and also for expanding the State's existing, albeit limited, medical marijuana program.

Attorneys

Arielle Doolittle

Practices & Industries

Agriculture

Cannabis & Hemp

State & Local Tax

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As the prospect of a legalized marijuana industry in New York State becomes increasingly likely, prospective participants in the industry will need to grapple with income tax considerations. On the one hand, all sales of medical marijuana, be they medical or recreational, constitute federal crimes,^[6] and reporting income from these sales on one's federal income tax return could be rather incriminating. Of course, not reporting the income presents a host of other potential problems.

Another more imminent income tax issue lies in a provision of the Internal Revenue Code under which no deductions or credits may be claimed for federal income tax purposes.^[7] This is because marijuana—medical or not—is still classified as Schedule I under the federal Controlled Substances Act. But in calculating taxable income, cannabis businesses may adjust gross receipts with respect to cost of goods sold. Since federal AGI is typically the starting point for state and local-level income tax computations, this limitation may have also have state-level income tax implications, unless New York acts to ensure a different result. And there is no indication yet that New York State will deviate from the standard rule. Only time will tell. We look forward to providing a more comprehensive update if and when the legislation is enacted. In the interim, for more information on the tax proposals, contact Ariele Doolittle (518-433-2407) and Chris Doyle (716-848-1458).

[1] See FY 2020 Revenue Memorandum in Support, Part VV, at page 58, available at <https://www.budget.ny.gov/pubs/archive/fy20/exec/artvii/revenue-artvii-ms.pdf>. "Adult use" is defined as age 21.

[2] Proposed N.Y. Tax Law § 493(a).

[3] Proposed N.Y. Tax Law § 493(b).

[4] Proposed N.Y. Tax Law § 493(c).

[5] Proposed N.Y. Tax Law § 494.

[6] See 21 U.S.C. § 841. The possession, use, distribution, and sale of marijuana and marijuana-based products is illegal under federal law despite certain state laws that decriminalize such activity. Federal enforcement policy may defer to a state's laws and not enforce conflicting federal laws, but the fact remains that compliance with state law in no way assures compliance with federal law, and there is a risk that conflicting federal laws may be enforced in the future.

[7] See IRS Chief Counsel Memo CCA 201504011 (released 1/23/2015).

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