

Absent express subtraction modification, medical cannabis dispensing organization operating costs that would be considered trafficking in marijuana under federal law cannot be deducted from AGI and must be included in the calculation of base income for purposes of calculating income tax due under the IITA. (This is a GIL.)

May 30, 2019

Re: Request for Private Letter Ruling; COMPANY

Dear Xxxx:

This is in response to your letter dated January 31, 2019, in which you request a Private Letter Ruling on behalf of COMPANY. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.tax.illinois.gov.

Your letter states as follows:

We are requesting a private letter ruling for the below referenced taxpayer.

A. Statement of Facts

1. Taxpayer Information

- a. This request for a Private Letter Ruling (PLR) is being made by the taxpayer NAME, President, for COMPANY.
- b. This Private Letter Ruling ("PLR") is not requested with regard to hypothetical or alternative proposed transactions.
- c. This PLR is requested to determine the Form IL-1120, Corporation Income and Replacement Tax consequences of actual business practices of COMPANY.
- d. COMPANY is not currently under audit or under any other type of litigation with the IL Department of Revenue on this matter or any other.
- e. The IL Department of Revenue has not previously ruled regarding this matter for COMPANY. In addition, COMPANY has not submitted any similar request on this same issue previously with the IL Department of Revenue.
- f. COMPANY requests that their name, address, location of its facilities, employees' names, description of facilities and any attached Exhibits be deleted from this PLR prior to making it public information.

2. Description of Taxpayer's Business Operations

COMPANY, is a medical cannabis dispensary that provides CITY, STATE and the surrounding counties with the highest quality PRODUCT and patient care available. The company's principal operations is the sale of PRODUCT to serve the medical needs of registered patients in the State of Illinois. COMPANY provides PRODUCT that can be administered using a variety of methods including: smoking, vaporizing, edibles, capsules, tinctures, sublingual's, topicals, hash and wax. COMPANY is located in CITY, STATE.

3. Material Facts Relating to Transaction

COMPANY follows strict guidelines for patients to be qualified to purchase their products. In order to become a patient the following items are required but not limited to: two proofs of residency, patient application form filled out, have a qualifying debilitating condition, have a signed physician certification form, complete a fingerprint-based background check and completed fingerprint consent form.

Section 280E of the Internal Revenue Code forbids businesses from deducting otherwise ordinary business expenses from gross income associated with the "trafficking" of Schedule I or II substances, as defined by the Controlled Substances Act. The IRS has subsequently applied Section 280E to state-legal cannabis business, since cannabis is still a Schedule I substance.

The Illinois General Assembly passed the Compassionate Use of Medical Cannabis Pilot Program Act in 2013 which went into effect on January 1, 2014..This law allows an individual who is diagnosed with a debilitating medical condition to register with the state in order to obtain cannabis for medical use.

Below are the different scenarios as it relates to the deductibility of medical cannabis operating expenses:

1. Taxpayer elects to be taxed as a Domestic Limited Liability Company
2. Taxpayer elects to be taxed as a Domestic C- Corporation

B. Prior Notices received (attached)

Taxpayer has received prior notices not allowing PRODUCT operating expenses to be deducted where they were originally reported on the filed tax return.

C. Ruling Requested

COMPANY respectfully requests from the Illinois Department of Revenue on how PRODUCT operating costs should be treated in the above scenarios 1 and 2.

1. Scenario 1 - Ordinary business expenses are items that would be taken into account by an individual in computing his or her taxable income. Can the taxpayer deduct PRODUCT operating expenses on Form IL-1065 Step 3 Line 11? If not, can they be deducted someplace else on the Form IL-1065?
2. Scenario 2 - Ordinary business expenses are items that would be taken into account in computing taxable income. Can taxpayer deduct PRODUCT operating expenses on Form IL-1120? If so, where should they be reported on Form IL-1120?

D. Statement of Law

Illinois Statutes mandate that the starting point for the Illinois Corporate Income Tax Return is federal taxable income, which is income minus deductions. Next, the federal taxable income is changed by adding back certain items (e.g., state, municipal, and other interest income excluded from federal taxable income) and subtracting others (e.g., interest income from U.S. Treasury obligations). The result is "base income."

Illinois law allows the deductibility of any legal operating expenses in the computation of taxable income. As a result, PRODUCT operating expenses would be deductible under this statute.

- E. Since the sale of PRODUCT is considered "MOVEING" as interpreted by the courts, any expenses incurred in the business of selling PRODUCT - even if permitted under state law - are not deductible at the federal level because PRODUCT is not legal at the federal level. The State of Illinois allows for the production and sale of PRODUCT and therefore the federal law 280E does not apply to Illinois COMPANIES. In passing Illinois PRODUCT laws, the legislature never addressed the deductibility of these costs and therefore, these costs are not deductible.

F. Additional Attachment

- a. IL-2848 Power of Attorney - Exhibit A
- b. Taxpayer statement dated November 30, 2018 for tax period December 31, 2017.
- Exhibit B

G. Signature

Under penalties of perjury, I declare that I have examined this request, including the accompanying documents, and to the best of my knowledge and belief the facts presented in support of the requested ruling are true, correct and complete.

Please send all questions or requests for additional information to me via email, by phone or by mail.

If you have any questions, please do not hesitate to contact me at ###.

RULING

Section 201(a) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/201) imposes a tax, measured by "net income," upon every individual, corporation, partnership, trust and estate for the privilege of earning or receiving income in or as a resident of the State. IITA Section 202 defines "net income" as that portion of the taxpayer's "base income" allocable to Illinois under the provisions of Article 3, less the standard exemption allowed under section 204. In the case of a corporation, IITA Section 203(b) defines the term "base income" to equal the taxpayer's adjusted gross income ("AGI") for federal income tax purposes, as modified by certain statutorily prescribed addition and subtraction modification. IITA Section 203(e) requires that a taxpayer's gross income, adjusted gross income, or taxable income for the taxable year shall mean the amount of gross income, adjusted gross income or taxable income

properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code. IITA Section 203(h) states that except as expressly provided by IITA Section 203, there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under the IITA for any taxable year. Therefore, absent a modification, expressly included in IITA Section 203, any item of income that is included or excluded in the computation of a taxpayer's federal taxable income (AGI) is likewise included or excluded in the computation of the taxpayer's Illinois base income.

Section 280E of the Internal Revenue Code, 26 U.S.C. § 280E states as follows:

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of MOVEING in PRODUCT substances (within the meaning of schedule I and II of the PRODUCT Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

21 U.S.C. §802(6) defines a "PRODUCT" as a drug or other substance, or immediate precursor, included in schedule I, II, III, IV, or V of part B of this subchapter. The term does not include distilled spirits, wine, malt beverages, or tobacco, as those terms are defined or used in subtitle E of the Internal Revenue Code of 1986. 21 U.S.C. §802(16) defines "PRODUCT" as all parts of the plant PRODUCT sativa L., whether growing or not; the seeds thereof; the resin extracted from any part of such plant; and every compound, manufacture, salt, derivative, mixture, or preparation of such plant, its seeds or resin. The term "PRODUCT" does not include: (i) hemp, as defined in section 1639o of Title 7; or (ii) the mature stalks of such plant, fiber produced from such stalks, oil or cake made from the seeds of such plant, any other compound, manufacture, salt, derivative, mixture, or preparation of such mature stalks (except the resin extracted therefrom), fiber, oil, or cake, or the sterilized seed of such plant which is incapable of germination.

21 U.S.C. §812 establishes five schedules of controlled substances. Schedule I is a drug or substance that has a high potential for abuse; has no currently accepted medical use in treatment in the United States; and for which there is a lack of accepted safety for use of the drug or other substance under medical supervision. 21 U.S.C. §812(b). PRODUCT, as defined above, is listed as a Schedule I controlled substance. The Illinois Compassionate Use of PRODUCT Pilot Program Act, 410 ILCS 130/1 *et seq.*, does nothing to modify the fact that PRODUCT is a controlled substance under federal law.

In the present case, whether the ordinary and necessary business expenses incurred by COMPANY as part of operating a BUSINESS dispensing organization are included in base income depends on whether the same amounts must be included in federal AGI. Absent an express subtraction modification, if such amounts must be included in federal AGI, they must also be included in Illinois base income. Under current federal law, a business that is engaged in the MOVEING of PRODUCT, cannot deduct the ordinary and necessary business expenses usually afforded to other industries. At this time, there is no express subtraction modification present in IITA Section 203 allowing a taxpayer to deduct the ordinary and necessary business expenses for operating a BUSINESS dispensing organization in this State licensed under the Compassionate Use of PRODUCT Pilot Program Act.

Given the lack of an express subtraction modification, according to Section 280E of the Internal Revenue Code, any of COMPANIES BUSINESS dispensing organization operating costs that would be considered MOVEING in PRODUCT under federal law cannot be deducted from federal taxable income (AGI) and must therefore be included in the calculation of base income for purposes of calculating COMPANIES income tax due under the IITA.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions regarding this letter, you may contact me at (217) 782-2844.

Sincerely,

Michael D. Mankowski
Associate Counsel (Income Tax)