New Jersey Society of Certified Public Accountants
Cannabis Interest Group

The New Jersey Society of Certified Public Accountants ("NJCPA") recently issued a proposal for the State of New Jersey to consider decoupling from Internal Revenue Code ("IRC" or the "Code") §280E for operations that meet the definition of a "small business," as defined by the IRC §448. On the surface, the Code provides a threshold of $25 million in average annual gross receipts as the basis for this determination. However, some of the nuances of the Code provide for additional protections for the small business status, which prevents large business from taking advantage of the status via clever tax maneuvers. This section of the Code was called into relevance upon the ratification of the Tax Cuts and Jobs Act, which refers to the small business test to determine companies' qualifications for various tax benefits. The Internal Revenue Service provides "the application of [the] rules [are] **designed to prevent taxpayers from circumventing the section 448(c) gross receipts test by dividing into multiple related entities that individually could meet the section 448(c) gross receipts test."[1]**

The purpose of this paper is to explain the application of IRC §448 from a simplified perspective. As this code section is complex, we intend to convey high level concepts in this brief memo. The footnotes and additional references are designed to help the interested reader better understand the concepts outlined below.

Tests to Aggregate Gross Receipts for the Purpose of Determining Small Business Status Under Internal Revenue Code §448(c)(2)

- Entities' receipts should be aggregated under the controlled group rules of §52(a) or §52(b) if they are a:[2]
  - Parent-subsidiary controlled group - looks at parent company's ownership of entities to determine common ownership for the purpose of aggregating receipts.[3]
  - Brother-sister controlled group - looks at the individual of ownership of groups of entities to determine common ownership for the purpose of aggregating receipts.[4, 5]
  - Combined group - looks at relationships between various parent-subsidiary and brother-sister controlled groups to determine common ownership for the purpose of aggregating receipts.[6]
- Entities' receipts should be aggregated under the affiliated service group rules of §414(m) if they are:[7]
  - Affiliated service group type A and/or B – looks at corporate structures' degree of ownership and services performed for one another to determine common ownership for the purpose of aggregating receipts.
  - Management affiliated service group – looks at the relationship of management companies with organizations who are the recipients of management services to determine common ownership for the purpose of aggregating receipts.

Additional Tax Shelter Rules Under Internal Revenue Code §448(d)(3)

- Entities' receipts should be aggregated under the tax shelter rules of §448(d)(3) if **the purpose of their existence or arrangement is the avoidance or evasion of income tax**.[8]

Additional References:

Internal Revenue Service FAQ
Tony Nitti, Forbes

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[1] Internal Revenue Service – FAQs Regarding the Aggregation Rules Under Section 448(c)(2) that Apply to the Section 163(j) Small Business Exemption ("IRS FAQs")
[2] See the IRS FAQs for details regarding constructive ownership (Part 1, Q-1, Q-5; Part 2, Q-10)
[3] See the IRS FAQs for specific details of parent-ownership controlled group tests (Part 1, Q-2)
[4] See the IRS FAQs for specific details of brother-sister controlled group tests (Part 1, Q-3)
[5] Rules to determine constructive ownership of groups that are not solely comprised of corporations differ slightly, refer to the IRS FAQs for more details (Part 2, Q-6 – Q-9)
[6] See the IRS FAQs for specific details of combined group tests (Part 1, Q-4)
[7] See the IRS FAQs for specific details of affiliated service groups (Part 3, Q-11)
[8] Several tests exist to determine if a structure is a tax shelter. Refer to §448(d)(3), §461(i)(3), §1256(e)(3)(B), and §662(d)(2)(C)(ii) for more details.