ISRAEL -UNITED STATES CANNABIS LAWS-TAX TRAP FOR THE UNWARY

Israel has become known as the most advanced country in the work for medical research relating to cannabis. The Israel Dangerous Drug Ordinance has been amended to allow for strictly regulated licensed activities which are legitimately connected to medical research and medical use. Government Regulation 1597 requires compliance with licensing and other legal requirements for any activity related to the cannabis plant or its derivative products including growing, exporting, distributing, possessing, transporting, laboratory testing, dispensing or research. The Israeli Government through its Ministry of Health established a dedicated agency, the Medical Cannabis Unit (IMCA) pursuant to Government Resolution No. 3609. The stated purpose of the IMCA is to provide patients with an appropriate source of supply of cannabis for medical purposes, while protecting the health, wellbeing, and security of the public. The IMCA has four primary policy objectives which are: medicalization of the cannabis plant, indications for provision of cannabis, standardization of cannabis products and training physicians in cannabis treatments.

The Israeli Government also promotes investment in cannabis related research through its Ministry of Economy and Trade and has even published a brochure encouraging foreign investment in Israel's Cannabis eco-system.[1]

Recreational use of cannabis remains unlawful in Israel, although there have been proposals to legalize it. Most recently, Israel changed its criminal laws to decriminalize or reduce penalties for certain minor possession offences involving cannabis. However, cannabis remains a dangerous drug which is regulated by Israel's Dangerous Drug Ordinance and possession of

[1] The Medical Cannabis Eco-System in Israel -A short Guide to your next best investment
The Foreign Investments and Industrial Cooperation Authority- investinisrael.gov.il

anything other than a small quantity, production, sale, and distribution are still subject to criminal penalties.

In the United States, the Federal Controlled Substance Act still classifies cannabis as a controlled substance as defined in 21 U.S.C. 802. Simple possession of cannabis remains a criminal offence under Federal law and production and distribution may be considered drug trafficking, an offence that can trigger felony criminal penalties. By contrast, a number of States have decriminalized simple possession of small quantities of cannabis with legislation analogous to that passed in Israel. Some States have also established a legal and regulatory framework for licensing cannabis for recreational as well as medical use. In this regard, the laws of certain States are broader that the current laws in Israel which still prohibits recreational use. At the end of March 2021, legislation passed by New York State (S.854-A/A.1248-A) established the Office of Cannabis Management. The new law expanded New York's Existing Medical Marijuana Program and established a licensing System which is broader than system overseen by the IMCA in Israel.

The similarities between the legal treatment and regulation of cannabis in Israel and the United States can only be found in those States like New York which have established a regulatory framework. Investors in New York may receive tax benefits as wall as other incentives if they establish a cannabis business in the State.[2] New York is projecting a 4-billion-dollar industry as a result of its new legislation. This has resulted in a flurry of activity from Israeli cannabis

[2] See https://esd.ny.gov/doing-business-ny/tax-based-incentives for description of the tax credit and other incentives offered by New York State described in a publication of Empire State Development which also has a representative office in Israel.

companies involved in production for recreational as well as medical use and other companies involved in medical devices.

Existing and potential investors and Israel cannabis industry professionals should take precautions to understand and plan for the significantly disparate treatment of taxation of proceeds and profits related to cannabis activities in the United States. The Federal Internal Revenue Code section 280 E precludes businesses from deducting ordinary and necessary expenses which are related to a cannabis business. Section 280 E provides:

"*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 trafficking in controlled substances (within the meaning of schedule I or II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.*"

In simple terms, a business which establishes itself in New York or any of the other State which allows for lawful production and sale of Cannabis and Cannabis products is eligible only for the State tax credit and deduction for ordinary business expenses. In April 2021, a Circuit Court of Appeals denied a challenge to the constitutionality of the Internal Revenue Code section 280 E and found that the petitioner remained liable for 4. 2 million dollars of back taxes.[3] This means, in practice, that most business expenses including salaries and employee benefits, utilities, marketing costs and lease payments will not be deductible from revenues. Fortunately, the limitation on tax deductions does not apply to cost of goods sold. Nevertheless, the elimination of the Federal tax deduction can result in a significantly higher tax burden and corresponding lower returns for investors in cannabis businesses in the United States. US and other investors who are engaged in cannabis production of products related to medical research may now wish to explore opportunities

[3] Patients Mutual Assistance Collective Corporation dba Harborside Health Center v Commissioner of Internal Revenue Ninth Circuit Court of Appeals case no 19-73078 published April 22, 2021

to manufacture and distribute their products in Israel. Careful tax planning through establishing an Israel company may result in a reduced tax burden and higher returns to investors.

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