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OAKLAND

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# AGENDA REPORT

**TO:** Sabrina B. Landreth  
City Administrator

**FROM:** Adam Benson  
Director of Finance

**SUBJECT:** Cannabis Business Tax Rates  
Amendments Supplemental

**DATE:** October 14, 2019

City Administrator Approval

Date:

10/17/19

## RECOMMENDATION

**Staff Recommends That The City Council Receive An Informational Report Regarding The Proposed Ordinances To The Oakland Municipal Code Title 5, Chapter 5.04, Section 5.04.480, Medical Cannabis Businesses, And Section 5.04.481, Non-Medical Cannabis Businesses, To Reduce The Tax Rates For Cannabis Businesses.**

## REASON FOR SUPPLEMENTAL

This supplemental report is to provide the City Council with the financial impact to the Fiscal Year ("FY") 2019-21 Adopted Policy Budget on two sets of proposed changes to the business tax rates on cannabis businesses. The proposed changes are:

- A. Councilmember Taylor's Proposal B<sup>1</sup>, as presented to the Finance & Management Committee meeting of September 24, 2019:

		Tax Rate	Tax Deduction
<b>Baseline Tax Rate</b>			
1	Manufacturing, Distribution, and Retail	5 % & 8%	
2	Cultivation <sup>2</sup>	5% & 10%	
3	Distribution & Laboratory/Testing	5%	
<b>Equity &amp; Small Business Tax Relief</b>			
4	Equity businesses with revenue up to \$1.5M	0.12%	
5	Non-Equity businesses with revenue up to \$500K	0.12%	
<b>Local Equity Hiring Incentive (3% Max Rebate)</b>			
6	Local Hiring Incentive A	1% reduction for 51% workforce consists of verified members of equity targeted population	

<sup>1</sup> Councilmember Taylor's Proposal A was analyzed and included in the Supplemental Finance Report – 10/4/19.

<sup>2</sup> For the purpose of providing financial impact, only the person or an entity engaging in cultivation-only operation would be subject to the existing tax rates of 5% and 10%. A person or an entity engages in cannabis business that produces gross receipts from more than one taxable activities (e.g. cultivation, manufacturing, distribution, retail, etc.) would pay the highest tax rate applicable to their operations.

7	Local Hiring Incentive B	1% reduction for 30% of essential jobs of the permit performed by verified members of equity targeted population
8	Local Hiring Incentive C	1% reduction for 30% of managerial staff are verified members of equity target population
<b>Equity Program Supply Chain Support (2% Max Rebate)</b>		
9	Local Supply Chain Discount A	1% reduction for 51% of product comes from equity distributor
10	Local Supply Chain Discount B	1% reduction for 51% of product on shelves are equity brand
<b>Workforce Quality of Life (2% Max Rebate)</b>		
11	Living Wage Discount A	1% reduction for no staff earning less than \$20/hr. (COLA adjustment each year)
12	Living Wage Discount B	1% reduction for 81% of staff working full-time

B. Council President Kaplan's request to analyze a "compromised" proposal from a group of cannabis businesses proposing to combine and compromise existing proposals from Councilmember Taylor and the joint proposals from Councilmembers Kalb & Council President Kaplan. The "compromised" proposal is as follow:

	Calendar Year 2020	Calendar Year 2021	Calendar Year 2022
Tax Rate: Equity Businesses	\$1.5m & under @ 0.12%	\$1.5m & under @ 0.12%	\$1.5m & under @ 0.12%
Non-Equity Businesses	\$500k & under @ 0.12%	\$500k & under @ 0.12%	\$500k & under @ 0.12%
Retail, Distribution, Manufacturing, Lab, Cultivation,	8% non-medical 5% medical	6.5% non-medical 5% medical	5% harmonized
<p><b>1. Local Equity Hiring Incentive (1.5% Max Rebate)</b></p> <ul style="list-style-type: none"> <li>Local Hiring Incentive A: 0.5% Tax Rebate – 30% of the workforce consists of verified members of equity target population.</li> <li>Local Hiring Incentive B: 0.5% Tax Rebate – 25% of essential jobs of the permit performed by verified members of equity target population (e.g. mfg. jobs for a manufacturer).</li> <li>Local Hiring Incentive C: 0.5% Tax Rebate – 20% of managerial staff are verified members of equity target population.</li> </ul> <p><b>2. Equity Program Supply Chain Support (1% Max Rebate)</b></p> <ul style="list-style-type: none"> <li>Local Supply Chain Discount A: 0.5% Tax Rebate – 30% of product comes from equity distributor.</li> <li>Local Supply Chain Discount B: 0.5% Tax Rebate – 25% of product on shelves are equity brand.</li> </ul> <p><b>3. Workforce Quality of Life Incentive (0.5% Max Rebate)</b></p> <ul style="list-style-type: none"> <li>Living Wage Discount 0.25% Rebate – No staff earns less than \$20/hr. with benefits or</li> </ul>			

\$25/hour without benefits (COLA adjustment each year)

- Full-time Hire Discount 0.25% Tax Rebate – 80% of staff is full time

**4. Equity Business Incubation (1.0%)**

- If a business chooses to incubate an equity business as defined in the Oakland Municipal Code.

The FY 2019-21 Adopted Policy Budget includes General Purpose Fund revenues derived from cannabis business activities of approximately \$14.6 million in year one (FY 2019-20) and \$15.7 million in year two (FY 2020-21).

**Staff is recommending against the adoption of all proposals.**

For Councilmember Taylor’s proposal, as outlined above, the proposed changes would result in the following financial impact:

- For items A.1, A.2, and A.3, the changes would have a collective negative financial impact of approximately -\$8.8 million in the current two-year adopted budget;
- For item A.4, the change would have a collectively negative financial impact of approximately -\$483,000 in the current two year-adopted budget;
- For item A.5, this proposed change was included in the FY 2019-21 Adopted Policy Budget following the City Council approval of a fixed tax rate of 0.12 percent that is applicable to all cannabis businesses generating \$500,000 or less in gross receipts; and,

For the “compromised” proposal, as outlined above, the proposed changes would result in the following financial impact:

- For 2020: the change would have a negative financial impact of approximately -\$3.7 million to the current FY 2019-20 Adopted Policy Budget.
- For 2021: the change would have a negative financial impact of approximately -\$5.6 million to the FY 2020-21 Adopted Policy Budget.
- For 2022, the financial impact would depend on whether either or both proposed changes to take effect in 2020 and 2021 are adopted. The impact would be drastic if both proposed changes are not approved and implemented because the proposed budget for FY 2021-23 would likely be based on prior year revenue collection from cannabis businesses. On the other hand, the impact would be less drastic if either or both proposed changes are adopted in either 2020 or 2021 or both because the current two-year adopted budget would have absorbed the financial impact.

The financial impact for all proposed tax rebate programs is unknown. A tax rebate, as proposed in all programs, is essentially a refund of the taxes paid after cannabis businesses meet a certain threshold as outlined in each program. Cannabis businesses would be required to pay the tax based on the tax rates that are in effect for the tax year in question. Following the close of the tax year or at the time the subsequent tax year is due and payable, businesses would then apply and submit documentation for the purpose of verification. If approved, businesses would either receive a refund of the taxes or a credit of the previously paid taxes toward the business tax obligation for the following year. The cycle would continue as long as the tax rebate programs are in effect.

## **BACKGROUND / LEGISLATIVE HISTORY**

On June 18, 2019, the City Council adopted amendments to Title 5, Chapter 5.04, Sections 5.04.480 and 5.04.481 of the Oakland Municipal Code ("OMC"). The amendments reduced the effective business license tax rate on cannabis business with total gross receipts of less than or equal to \$500,000 to a new fixed tax rate of 0.12 percent, or \$1.20 per \$1,000, of gross receipts. The City Council held over discussion of reducing business tax rates on cannabis business with total gross receipts in excess of \$500,000 to a future date.

On September 24, 2019, Councilmember Taylor proposed a new set of Cannabis Business Tax rates as part of "Proposed Cannabis Equity Tax Incentive Program." Five of the seven items included in the program involve the reduction of tax rates while the remaining two involve tax incentives in the form of tax credit or tax rebate if cannabis businesses meet a certain employment hiring threshold.

On October 4, 2019, Councilmember Taylor added an alternative proposal, called Proposal B, and renamed the proposal of September 24, 2019 as Proposal A. Proposal B also called for the reduction of tax rates for different operations and expanded the "Proposed Cannabis Equity Tax Incentive Program" in the form of tax rebates if cannabis businesses meet a certain threshold in the areas of local hiring, support of local supply chain, and workforce incentive.

## **ANALYSIS AND POLICY ALTERNATIVES**

The FY 2019-21 Adopted Policy Budget contemplated **no changes** to the existing business tax structure of 5 percent on gross receipts derived from medical cannabis and 10 percent on gross receipts derived from non-medical cannabis assessed on cannabis business with total annual gross receipts of \$500,000 or more. Any changes to the business tax that is effective January 1, 2020 will negatively impact both years of the Adopted Fiscal Years 2019-21 Budget.

**Councilmember Taylor's Proposal**

**Table 1: Financial Impact to FY 2019-21 Adopted Policy Budget (A.1 – A.3)**

Proposal No.	Gross Receipts Category	Existing Tax Rates	Number of Businesses	Existing Revenue (FY 2018-19)	New Tax Rates	Estimated Revenue	Difference	Combined FYs 2019-21
<b>Already Enacted</b>	Up to \$500K (All Cannabis Businesses, including Cultivation-Only Activity)	5% & 10%	150	\$770,351	0.12%	\$11,224	(\$759,127)	
<b>Baseline Tax Rate</b>								
<b>1</b>	Above \$500K (Manufacturing, Distribution & Retail)	5% & 10%	34	\$10,126,281	5% & 8%	\$8,502,974	(\$1,623,307)	
<b>2</b>	Above \$500K (Cultivation Only Activity)	5% & 10%	3 <sup>3</sup>	\$298,453	5% & 10%	\$298,453	\$0	
<b>3</b>	Above \$500K (Distribution & Laboratory Testing)	5% & 10%	8	\$2,549,006	5%	\$1,558,015	(\$990,992)	
	<b>Total</b>		<b>195</b>	<b>\$13,744,091</b>		<b>\$10,359,442</b>	<b>(\$2,614,298)</b>	
<b>Surplus/(Deficit) Relative to FY 2019-20 Adopted Revenues (\$14,567,893)</b>							<b>(\$4,208,451)<sup>4</sup></b>	
<b>Surplus/(Deficit) Relative to FY 2020-21 Adopted Revenues (\$15,733,167)</b>							<b>(\$4,544,970)<sup>5</sup></b>	<b>(\$8,753,421)</b>

**Table 2: Financial Impact to FY 2019-21 Adopted Policy Budget (A.4 – A.5)**

Proposal No.	Gross Receipts Category	Existing Tax Rates	Number of Businesses	Existing Revenue (FY 2018-19)	New Tax Rates	Estimated Revenue	Difference	Combined FYs 2019-21
<b>4</b>	Equity Businesses with Revenue up to \$1.5M	5% & 10%	3	\$235,823	0.12%	\$3,702	\$232,120	
<b>Surplus/(Deficit) Relative to FY 2019-20 Adopted Revenues (\$14,567,893)</b>							<b>(\$232,120)</b>	
<b>Surplus/(Deficit) Relative to FY 2020-21 Adopted Revenues (\$15,733,167)</b>							<b>(\$250,690)</b>	<b>(\$482,810)</b>
<b>5</b>	Non-Equity Businesses with Revenue Up to \$500K	5% & 10%	<b>Included FY 2019-21 Adopted Budget Policy</b>		0.12%	<b>Included FY 2019-21 Adopted Budget Policy</b>		

<sup>3</sup> Only three (3) cannabis businesses engaged in cultivation-only operation for 2019 Tax Year and generated more than \$500,000 in gross receipts. If the gross receipts remain above \$500,000 for 2020 Tax Year, these would be the only three businesses paying the existing tax rates of 5% and 10%.

<sup>4</sup> Exclude \$11,224 in the Up to \$500K category since the estimated revenues have already been included in FY 2019-21 Adopted Budget Policy.

<sup>5</sup> The FY 2019-21 Adopted Budget Policy included an increase of 8% for FY 2020-21 from FY 2019-20. The deficit for FY 2020-21 is therefore increased by an additional 8%.

***“Compromised” Proposal to Begin in 2020***

Table 3 depicts the financial impact to the current FY 2019-20 Adopted Policy Budget if the proposal is approved and adopted to begin in January 2020.

**Table 3: Financial Impact to FY 2019-20 Adopted Policy Budget**

Proposal No.	Gross Receipts Category	Existing Tax Rates	Number of Businesses	Existing Revenue (FY 2018-19)	New Tax Rates	Estimated Revenue	Difference
Already Enacted	Up to \$500K (All Cannabis Businesses, including Equity Businesses)	5 % & 10 %	150	\$770,351	0.12%	\$11,224	(\$759,127)
1	Above \$500K (All, except Equity Businesses)	5 % & 10 %	41	\$12,405,122	5% & 8%	\$10,634,520	(\$1,770,603)
2	Equity Businesses with Revenue above \$500K but equal or less than \$1.5M	5 % & 10 %	3	\$235,823	0.12%	\$3,702	(\$232,120)
3	Equity Businesses with Revenue above \$1.5M	5 % & 10 %	1	\$332,795	5% & 8%	\$269,677	(\$63,118)
	<b>Total</b>		<b>195</b>	<b>\$13,744,091</b>		<b>\$10,359,442</b>	<b>(\$2,065,841)</b>
<b>Surplus/(Deficit) Relative to FY 2019-20 Adopted Revenues (\$14,567,893)</b>							<b>(\$3,659,994)</b>

***“Compromised” Proposal to Begin in 2021***

Table 4 depicts the financial impact to the next FY 2020-21 Adopted Policy Budget if the proposal is approved and adopted to begin January 2021.

**Table 4: Financial Impact to FY 2020-21 Adopted Policy Budget**

Proposal No.	Gross Receipts Category	Existing Tax Rates	Number of Businesses	Existing Revenue (FY 2018-19)	New Tax Rates	Estimated Revenue	Difference
Already Enacted	Up to \$500K (All Cannabis Businesses, including Equity Businesses)	5% & 10%	150	\$770,351	0.12%	\$11,224	(\$759,127)
1	Above \$500K (All, except Equity Businesses)	5% & 10%	41	\$12,405,122	5% & 6.5%	\$9,129,701	(\$3,275,422)
2	Equity Businesses with Revenue above \$500K but equal or less than \$1.5M	5% & 10%	3	\$235,823	0.12%	\$3,702	(\$232,120)
3	Equity Businesses with Revenue above \$1.5M	5% & 10%	1	\$332,795	5% & 6.5%	\$222,338	(\$110,456)
	<b>Total</b>		<b>195</b>	<b>\$13,744,091</b>		<b>\$9,355,741</b>	<b>(\$3,617,999)</b>
<b>Surplus/(Deficit) Relative to FY 2020-21 Adopted Revenues (\$15,733,167)</b>							<b>(\$5,628,966)</b>

**“Compromised” Proposal to Begin in 2022**

For 2022, the financial impact would depend on whether either or both proposed changes to take effect in 2020 and 2021 are adopted and implemented. The impact would be drastic if both proposed changes are not approved and implemented because the proposed budget for FY 2021-23 would likely be based on prior year collection of the taxes. On the other hand, the impact would be less drastic if either or both proposed changes are adopted and implemented in either 2020 or 2021 or both because the current two-year adopted budget would have absorbed the financial impact.

**Harmonizing Medical and Non-Medical Tax Rates for Non-Retailers:**

Most retailers can easily determine whether a cannabis purchase is for medical or for non-medical use by verifying whether the purchaser has a valid state-issued Medical Marijuana Identification Card (“MMIC”)<sup>6</sup>. Unfortunately, non-retailers have no such ability because they engage directly with businesses. In short, most non-retailers have no way of knowing how much of their gross receipts are derived from medical or non-medical sales. Hence, the separation of the gross receipts for non-retailers cannot be easily done.

One possible course of action is to harmonize the two tax rates (5% & 10%) into one tax rate (such as 5%). Table 5 below depicts the financial impact if the tax rate for non-retailers were to be set at 5% while keeping the rates for retailers at 5% (medical) and 10% (non-medical).

**Table 5: Financial Impact to FY 2020-21 Adopted Policy Budget**

Gross Receipts Category	Existing Tax Rates	Number of Businesses	Existing Revenue (FY 2018-19)	New Tax Rates	Estimated Revenue	Difference	Combined FYs 2019-21
Up to \$500K	5% & 10%	150	\$770,351	0.12%	\$11,224	(\$759,127)	
Over \$500K - Retailers (Dispensary & Non-Store Front Delivery)	5% & 10%	13	\$7,115,371	5% & 10%	\$7,115,371	\$0	
Over \$500K - Non-Retailers (Cultivation, Manufacturing, Distribution & Testing)	5% & 10%	32	\$5,858,369	5%	\$3,649,405	(\$2,208,964)	
<b>Total</b>		195	\$13,744,091		\$10,776,000	(\$2,968,091)	
<b>Surplus/(Deficit) Relative to FY 2019-20 Adopted Revenues (\$14,567,893)</b>						<b>(\$3,803,117)<sup>7</sup></b>	<b>(\$7,910,326)</b>
<b>Surplus/(Deficit) Relative to FY 2020-21 Adopted Revenues (\$15,733,167)</b>						<b>(\$4,107,209)<sup>8</sup></b>	

<sup>6</sup> The validation of MMIC is also used for the purpose of exempting Sales and Use Tax.

<sup>7</sup> Exclude \$11,224 in the Up to \$500K category since the estimated revenues have already been included in FY 2019-21 Adopted Budget Policy.

<sup>8</sup> The FY 2019-21 Adopted Budget Policy included an increase of 8% for FY 2020-21 from FY 2019-20. The deficit for FY 2020-21 is therefore increased by an additional 8%.

Furthermore, the change would eliminate the need to re-configure the system (at an estimated cost ranging from \$250,000 to \$350,000 depending on the complexity and the versatility of the configuration) and additional staffing costs (at an estimated cost ranging from \$350,000 to \$500,000 per year for the next two years).

### **FISCAL IMPACT**

The FY 2019-21 Adopted Policy Budget includes estimated General Purpose Fund revenues derived from cannabis business activities of \$14.6 million in year one and \$15.7 million in year two. Based on the two sets of proposed tax structures, the FY 2019-21 Adopted Policy Budget would decrease from a low estimate of approximately \$480,000 (Item 4 of Councilmember Taylor's proposal) to a high estimate of approximately \$9.3 million (\$3.7M for FY 2019-20 + \$5.6M for FY 2020-21) under the "Compromised" proposals that would become effective in 2020 and 2021.

**Staff is recommending against the adoption of the proposed changes because of the negative financial impact to the FY 2019-21 Adopted Policy Budget. If any of the proposed changes is approved, the change would necessitate a cut in services or an identification of alternative funding source to re-balance the FY 2019-21 Adopted Policy Budget.**

In addition to the fiscal impact to the FY 2019-21 Adopted Policy Budget, the financial impact related to the re-configuration of the computer system to accommodate the changes would be a one-time cost ranging from \$250,000 to \$350,000 depending on the changes and the versatility the computer system needs to have in order to administer various tax programs. In addition to the reconfiguration of the local tax software, additional 2-3 staff would be required to audit and ensure compliance with the program. The estimated cost is at \$350,000 - \$500,000 per year.



**ACTION REQUESTED OF THE CITY COUNCIL**

Staff recommends that the City Council receive this informational report regarding the proposed changes amending Oakland Municipal Code Title 5, Chapter 5.04, Section 480, Medical Cannabis Business, and Section 481, Non-Medical Cannabis Businesses, to reduce the tax rates for cannabis businesses.

For questions regarding this report, please contact Margaret O'Brien, Revenue & Tax Administrator, (510) 238-7480.

Respectfully submitted,



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Adam Benson  
Director of Finance  
Finance Department

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