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OAKLAND

2019 MAY -9 PM 12: 38

AGENDA REPORT

TO: Sabrina B. Landreth
City Administrator

FROM: Katano Kasaine
Director of Finance

SUBJECT: Cannabis Business Tax Rates
Amendments

DATE: May 7, 2019

City Administrator Approval

Date:

5/8/19

RECOMMENDATION

Staff Recommends That The City Council Receive An Informational Report Regarding The Proposed Ordinance Amending 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 REPORT

This supplemental report is to replace the report previous published May 2, 2019, correcting **Tables 4, 5 and 6** as previously submitted.

EXECUTIVE SUMMARY

The focus of this informational report is to address Councilmember Kalb's proposal to change the existing cannabis business tax of \$50 for each \$1,000 of gross receipts (5 percent) on medical cannabis businesses and \$100 for each \$1,000 of gross receipts (10 percent) on non-medical cannabis businesses to a new tax structure. The proposal would create four different brackets of gross receipts wherein each bracket would have its own tax rates for different segments, or business activities, within the supply chain of the cannabis industry.

Staff is recommending against the adoption of the proposed changes due to the negative fiscal impact of approximately -\$8.4 million in Fiscal Year (FY) 2019-20 and -\$9.0 million in FY 2020-21 of the FY 2019-2021 Proposed Policy Budget.

	FY 2019-20	FY 2020-21
FY 2019-21 Proposed Budget Revenues	\$15,070,000	\$16,275,600
Councilmember Kalb's Proposal	\$6,718,800	\$7,256,304
Surplus / (Deficit)	(\$8,351,200)	(\$9,019,296)
Equivalent No. of Budgeted FTEs	48.50 FTE	50.50 FTE

Staff further recommends to defer action until additional analyses can be performed and determine the financial impact it will have on the City's budget.

BACKGROUND / LEGISLATIVE HISTORY

In November 2010, Oakland voters approved Measure V increasing the tax rate on medical cannabis businesses from 1.8 percent (1.80%) to five percent (5.00%) and creating a new tax rate of 10 percent (10.00%) of gross receipts on non-medical cannabis businesses, commonly referred to as adult-use or recreational. The additional 10 percent adult-use tax rate was put forth in anticipation of Proposition 19 being passed in the same election. Proposition 19 failed at the ballot box. As a result, Oakland never implemented the adult-use tax rate. Oakland's adult-use tax rate became effective for the first-time on January 1, 2018 following the passage of Proposition 64 statewide in November 2016.

In February 2018, staff prepared and provided the City Council an informational report on Cannabis Business Tax Policy Analysis¹ that was drawn upon the work done by the Marijuana Policy Group, the University of the Pacific, Center for Business & Policy Research, and staff's own experience in working the local cannabis businesses. The City Council received and filed the report on March 6, 2018.

In June 2018, the City Council adopted Resolution No. 87247 C.M.S submitting for voter consideration at the statewide general election on November 6, 2018 a proposed ordinance to (1) allow cannabis businesses to pay business taxes quarterly; (2) allow cannabis manufacturing and/or cultivation businesses to deduct the value of raw materials from gross receipts in calculating business taxes; and (3) authorize the City Council, without returning to voters, to amend medical or non-medical cannabis business taxes in any manner that does not increase the tax rate.

In November 2018, Oakland voters, by a margin of 79.82 percent, approved the Oakland City Council, on its own motion, Measure V (1) allowing cannabis businesses to pay business taxes quarterly; (2) allowing cannabis manufacturing and/or cultivation businesses to deduct the value of raw materials from gross receipts in calculating business taxes; and (3) authorizing the City Council, following a public hearing and without returning to voters, to amend the tax rates applicable to medical and/or non-medical cannabis businesses engaged in any or all categories of cannabis business.

¹ Cannabis Business Tax Policy Analysis:
<https://oakland.legistar.com/LegislationDetail.aspx?ID=3268538&GUID=D31F72D6-2697-4D9D-B4E4-73BBBAF2F7DE&Options=&Search=>

In January 2019, staff prepared and provided the City Council an informational report regarding the proposed ordinance reducing the tax rate for non-medical cannabis businesses to be the same as the medical cannabis business tax rates of \$50 per \$1,000 of gross receipts (5 percent). Staff recommended against the adoption of the proposed ordinance because it would create an ongoing negative financial impact of approximately -\$1.8 million without identifying balancing measures. In addition, it would negatively impact the possible 1% wage increases based upon the performance of unrestricted local tax revenues that is memorialized in all civilian labor bargaining groups' Memorandums of Understanding and the Local 55 Arbitration award. The Finance & Management Committee continued the item to the February 19, 2019 meeting and has since postponed the item until the Administration has completed its analysis of cannabis business tax filings and payments following the renewal season that ended on April 10, 2019.

ANALYSIS AND POLICY ALTERNATIVES

Current Business Tax Structure:

Under the current tax structure, all businesses are required to pay taxes based on the prior year's gross receipts, e.g. 2019 Tax Year is based on the actual gross receipts generated in 2018. For the 2019 business tax renewal, cannabis businesses reported aggregated gross receipts totaling \$165.35 million, and are remitting aggregated taxes, based upon the current tax structure, totaling \$13.7 million. Of the \$13.7 million, \$7.4 million (54%) was derived from retail cannabis activity while \$6.3 million (46%) was derived from all other cannabis activities, such as manufacturing and cultivation.

Table 1 provides a summary of cannabis business tax revenue following the completion of the business tax renewal period that ended on March 1, 2019. **Table 2** provides a summary breakdown of revenue received from medical and non-medical activities in 2019.

Table 1: Summary - Revenue Breakdown	Gross Receipts (subject to 2019 Tax)	2019 Tax
Total Revenue from Retailers	\$87,025,144	\$7,443,732
Total Revenue from Non-Retailers	\$78,326,186	\$6,300,359
Total	\$165,351,330	\$13,744,091

Table 2: Summary - Revenue Breakdown	Gross Receipts (subject to 2019 Tax)	2019 Tax
Total Revenue from Medical Tax Rate of 5%	\$55,819,926	\$2,790,987
Total Revenue from Adult-Use Tax Rate of 10%	\$109,531,404	\$10,953,104
Total	\$165,351,330	\$13,744,091

Proposed Ordinance Business Tax Structure:

Table 3 below depicts the tax structure that is being contemplated under the proposed Ordinance.

Table 3: Proposed Oakland Cannabis Business Tax Structure*			
Total Gross Receipts	<i>Cannabis Retail Businesses (including retail delivery)</i>	<i>Cannabis Manufacturing (including packaging and storage) and Cannabis Cultivation</i>	<i>Wholesale Distribution, Transportation (non-retail), and Testing</i>
Up to \$100,000 in gross receipts	\$1,500 (but no more than 5% of gross receipts)	\$1,500 (but no more than 5% of gross receipts)	\$1,500 (but no more than 5% of gross receipts)
Over \$100,000 up to \$1,000,000	\$1,500 + 3% of gross receipts (over \$100,000)	\$1,500 + 2.5% of gross receipts (over \$100,000)	\$1,500 + 1.5% of gross receipts (over \$100,000)
Over \$1,000,000 and up to \$5,000,000	\$1,500 + 3% of gross receipts over \$100,000 and up to \$1,000,000 + 5% of gross receipts over \$1,000,000	\$1,500 + 2.5% of gross receipts over \$100,000 and up to \$1,000,000 + 3.5% of gross receipts over \$1,000,000	\$1,500 + 1.5% of gross receipts over \$100,000 and up to \$1,000,000 + 2.0% of gross receipts over \$1,000,000
Over \$5,000,000	5% of total gross receipts (<i>no marginal rates</i>)	\$1,500 + 2.5% of gross receipts over \$100,000 and up to \$1,000,000 + 3.5% of gross receipts over \$1,000,000 and up to \$5,000,000 + 5% of gross receipts over \$5M	\$1,500 + 1.5% of gross receipts over \$100,000 and up to \$1,000,000 + 2.0% of gross receipts over \$1,000,000 and up to \$5,000,000 + 3% of gross receipts over \$5M
<i>*No distinction between medical and non-medical (adult use)</i>			

To provide an understanding of the negative fiscal impact that adoption of this Ordinance will have on the General Purposed Fund, the proposed tax structure was applied to the 2019 business tax remittances. The proposed tax structure would decrease revenues derived from business taxes assessed on cannabis business from \$13.74 million to \$6.11 million, or a net loss to the General Purpose Fund of -\$7.63 million. (**Table 4**)

Table 4: Proposed Ordinance When Applied to 2019 Revenue				
Marginal Tax Rates Based on Gross Receipts				
Category	Retail	Cultivation & Manufacturing	Distribution, Transporter & Testing	Total
Up to \$100K	\$64,797	\$57,494	\$33,050	\$155,341
\$100K+ - \$1M	\$387,795	\$332,844	\$235,375	\$956,014
\$1M+ - \$5M	\$737,210	\$709,726	\$285,820	\$1,732,756
Over \$5M	\$2,869,092	\$394,797	\$0	\$3,263,889
Total (FY 2018-19)	\$4,058,895	\$1,494,860	\$554,244	\$6,108,000

The FY 2019-20 Proposed Policy Budget contemplated no changes to the existing business tax structure of five percent (5%) on gross receipts derived from medical cannabis and 10 percent (10%) on gross receipts derived from non-medical cannabis. Thus, the Proposed Policy Budget includes General Purpose Fund revenues derived from cannabis business activities of \$15.07 million in year 1 and \$16.28 million in year 2. **Tables 5 and 6** reflect the impact on General Purpose Fund revenues in the FY 2019-21 Proposed Policy Budget if the tax structure being contemplated under this Ordinance is adopted.

Table 5: Proposed Ordinance When Applied to FY 2019-20 Revenues				
Marginal Tax Rates Based on Gross Receipts				
Forecasted FY 2019-20 Revenues				\$15,070,000
Category	Retail	Cultivation & Manufacturing	Distribution, Transporter & Testing	Total
Up to \$100K	\$71,277	\$63,243	\$36,355	\$170,875
\$100K+ - \$1M	\$426,575	\$366,128	\$258,912	\$1,051,615
\$1M+ - \$5M	\$810,931	\$780,698	\$314,402	\$1,906,032
Over \$5M	\$3,156,002	\$434,276	\$0	\$3,590,278
Total	\$4,464,784	\$1,644,347	\$609,669	\$6,718,800
Surplus/(Deficit) Relative to FY 2019-20 Proposed Revenues				(\$8,351,200)

Table 6: Proposed Ordinance When Applied to FY 2020-21 Revenues				
Marginal Tax Rates Based on Gross Receipts				
Forecasted FY 2020-21 Revenues				\$16,275,600
Category	Retail	Cultivation & Manufacturing	Distribution, Transporter & Testing	Total
Up to \$100K	\$76,979	\$68,303	\$39,263	\$184,545
\$100K+ - \$1M	\$460,701	\$395,419	\$279,625	\$1,135,744
\$1M+ - \$5M	\$875,806	\$843,154	\$339,554	\$2,058,514
Over \$5M	\$3,408,482	\$469,019	\$0	\$3,877,500
Total	\$4,821,967	\$1,775,894	\$658,442	\$7,256,304
Surplus/(Deficit) Relative to FY 2019-20 Proposed Revenues				(\$9,019,296)

Cannabis Activities and Tax Rates in Surrounding Jurisdictions:

In comparison to surrounding jurisdictions, the City of Oakland is one of a very limited number of local municipalities that allow businesses to engage in cannabis activities to the full extent provided by California law. In addition, the City does not limit the number of permits issued to cannabis businesses that can operate in the City. For this reason, Oakland has long been a draw for cannabis entrepreneurs and investors. However, Oakland offers more than just the ability for businesses to engage in cannabis activities. The availability of commercial and industry space in San Francisco and Berkeley is not as abundant when compared to Oakland. This results in cheaper rent and lower operating costs. Berkeley also limits the number of permits issued to cannabis activities. It should be noted that one of the often-mentioned local jurisdiction tax rates are that of San Francisco. Proposition D authorizes that City and County of San Francisco to impose the special tax rates, as outlined below, on cannabis businesses beginning in January 2021. The new San Francisco's cannabis business tax rates are **in addition to the existing tax rates** that range from 0.075 percent to 0.65 percent of gross receipts.

The listing below consists of local and notable jurisdictions that authorized cannabis business-related activities and their respective tax rates. (**Table 7**)

Table 7: Local Jurisdictions Authorized Cannabis Business Activities

Jurisdiction	Retail Medical	Retail Adult-Use	Cultivation	Manufacturing	Delivery	Testing
Berkeley	2.5%	5%	Medical=2.5% Adult-Use =5%	Medical=2.5% Adult-Use =5%	Medical=2.5% Adult-Use =5%	Medical=2.5% Adult-Use =5%
Hayward ²	Up to 15%	Up to 15%	Up to 15%	Up to 15%	Up to 15%	Up to 15%
Los Angeles ³	5%	10%	2%	2%	1%	1%
Oakland	5%	10%	5% & 10%	5% & 10%	5% & 10%	5% & 10%
Richmond	5%	5%	5%	5%	5%	5%
Sacramento	4%	4%	4%	4%	4%	4%
San Diego ⁴	5%	5%	5%	5%	5%	5%
San Francisco (In addition to regular gross receipts taxes) ⁵	>\$1M = 2.5% <\$1M = 5%	>\$1M = 2.5% <\$1M = 5%	>\$1M = 1% <\$1M = 1.5%	>\$1M = 1% <\$1M = 1.5%	>\$1M = 1% <\$1M = 1.5%	>\$1M = 1% <\$1M = 1.5%
San Jose	10%	10%	10%	10%	10%	10%
San Leandro ⁶	Up to 10%	Up to 10%	Up to 10%	Up to 10%	Up to 10%	Up to 10%
Santa Rosa ⁷	0%	3%	2%	1%	N/A	N/A

² City of Hayward's Measure EE authorized the City to impose a tax rate up to 15%. The City is in the process of finalizing the regulatory framework and approval of the tax rate to be imposed on approved businesses.

³ City of Los Angeles' Measure M (March 2017)

⁴ City of San Diego's current Tax Rate is 5%, going up to 8% in July 2019. The maximum tax rate is 15%.

⁵ City and County of San Francisco's Cannabis Taxes are **in addition** to the current gross receipts tax rates that range from 0.075 percent to 0.65 percent.

⁶ City of San Leandro's Measure NN authorized the City to impose a tax rate up to 10%. On March 20, 2017, the San Leandro City Council set the tax of 6%, 7% beginning in July 2019 and 8% beginning in July 2021.

⁷ City of Santa Rosa's Measure D authorized the City to impose a tax rate up to \$25 per square foot or 8% of gross receipts. Any tax rates set by the Council is for a minimum term of two years, but the Council may establish longer terms if desired. The initial tax rates are current set as outlined in the table, including 0% for retail of medical-use.

FISCAL IMPACT

The FY 2019-21 Proposed Policy Budget includes General Purpose Fund revenues derived from cannabis business activities of \$15.07 million in year one (1) and \$16.28 million in year two (2). Based on the tax structure being contemplated under the proposed Ordinance wherein the marginal tiered rates apply at each level of gross receipts, the General Purpose Fund forecast for FY 2019-20 and FY 2020-21 would decrease revenues to \$6.72 million and \$7.26 million, respectively. This would create a negative fiscal impact of approximately -\$8.35 million in FY2019-20 and -\$9.02 million in FY 2020-21 of the FY 2019-2021 Proposed Policy Budget.

Staff is recommending against the adoption of the proposed changes because of the negative financial impact of approximately -\$8.35 million in Fiscal Year (FY) 2019-20 and -\$9.02 million in FY 2020-21 of the FY 2019-2021 Proposed Policy Budget.

Due to the significant financial impact on the budget, staff further recommends that Council defers making any changes to the cannabis business tax rates structure until further analyses can be performed and return with a cannabis business tax rate structure that has no impact to the City's budget.

PUBLIC OUTREACH / INTEREST

No outreach was deemed necessary for this informational report beyond the standard Council agenda noticing procedures

COORDINATION

This report has been coordinated with the Budget Bureau.

SUSTAINABLE OPPORTUNITIES

Economic: A reduction of tax rates would allow the City to stay on par with tax rates in adopted in surrounding jurisdictions and possibly encourage more cannabis businesses to stay or to open in the City. Conversely, the reduction would also result in the lower tax revenue and possibly limit the City's ability to attract and diversify its economic base due to cannabis businesses taking up more industrial buildings and/or warehouses.

Environmental: The most important environmental concerns related to cannabis industry are in the consumption of water and the disposal of unused or discarded waste. Robust regulations regarding the disposal of waste should minimize the impact. The use of precious water resource is, at this time, unavoidable.

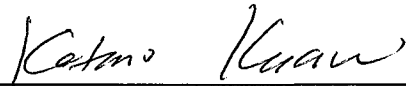
Social Equity: There is no social equity related to the proposed reduction of the tax rate.

ACTION REQUESTED OF THE CITY COUNCIL

Staff recommends that the City Council accept this informational report regarding the proposed Ordinance 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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