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AGENDA REPORT

TO: Sabrina B. Landreth
City Administrator

FROM: Katano Kasaine
Director of Finance

SUBJECT: Cannabis Business Tax Rates
Amendments Supplemental

DATE: July 1, 2019

City Administrator Approval

Date:

7/2/19

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 in response to new proposed marginal/tiered cannabis tax rates.

EXECUTIVE SUMMARY

The focus of this informational report is to provide the City Council with an updated financial impact to the Fiscal Years (FYs) 2019-21 Adopted Policy Budget following newly proposed marginal tiered tax rates as proposed by Councilmember Kalb. If adopted, the proposed Ordinance would create a transitional marginal tiered tax rate through the end of the FY 2020-21; and then, after absorbing the loss of General Purpose Fund revenue in FYs 2019-21, a wholly marginal tax rate effective January 1, 2022 that would impact the FY 2021-22 budget.

Staff is recommending against the adoption of the proposed changes to the Oakland Municipal code due to the negative fiscal impact of approximately -\$6.76 million in Fiscal Year (FY) 2019-20, -\$7.30 million in FY 2020-21 of the FY 2019-21 Proposed Policy Budget, and an additional -\$2.62 million of ongoing revenue beginning FY 2021-22 after adjusting for the transitional tax rate.

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. The amendments reduce the effective business license tax rate on cannabis business with total gross receipts of less than or equal to

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\$500,000 to \$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.

ANALYSIS AND POLICY ALTERNATIVES

The proposed Ordinance would create a transitional marginal tiered tax rate effective either January 1, 2020 or January 1, 2021; and then a wholly marginal business tax rate for cannabis businesses beginning January 1, 2022.

Proposed Ordinance Business Tax Structure Transitional, Effective January 1, 2020 or January 1, 2021

Proposed Oakland Cannabis Business Tax Structure (TRANSITIONAL)				
<u>Total Gross Receipts</u>	<u>Cannabis Retail Businesses (including retail delivery)</u>	<u>Cannabis Manufacturing (including packaging and storage) and Cannabis Cultivation</u>	<u>Wholesale Distribution and Transportation (non-retail) and Testing</u>	
Up to \$500,000 in gross receipts	.12% of gross receipts	.12% of gross receipts	.12% of gross receipts	Effective Jan. 2020 \ already enacted
Over \$500,000 up to \$1,000,000	.12% of gross receipts up to \$500,000 + 5% of gross receipts (over \$500,000 up to \$1,000,000)	.12% of gross receipts up to \$500,000 + 4.5% of gross receipts (over \$500,000 up to \$1,000,000)	.12% of gross receipts up to \$500,000 + 4% of gross receipts (over \$500,000 up to \$1,000,000)	Effective Jan. 2020 or 2021
Over \$1,000,000 and up to \$5,000,000	5% of total gross receipts (no marginal rates)	4.5% of total gross receipts (no marginal rates)	4% of total gross receipts (no marginal rates)	Effective Jan. 2020 or 2021
Over \$5,000,000	5% of total gross receipts (no marginal rates)	5% of total gross receipts (no marginal rates)	4% of total gross receipts (no marginal rates)	Effective Jan. 2020 or 2021
<i>*No distinction between medical and non-medical (adult use)</i>				

The recently adopted Fiscal Years (FYs) 2019-21 Adopted 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 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.

Tables 1 and 2 below reflect the impact on the General Purpose Fund in FYs 2019-20 and 2020-21 if the tax structure being contemplated under this Ordinance is adopted.

Table 1

Proposed Ordinance When Applied to FY 2019-20 Adopted Revenues				
Tiered and/or Marginal Tax Rates Based on Gross Receipts				
Adopted FY 2019-20 Revenues				\$14,567,983
Category	Retail	Cultivation & Manufacturing	Distribution & Transportation	Total
Up to \$500K	\$11,434	\$8,992	\$5,938	\$26,364
\$500K+ - \$1M	\$94,831	\$44,397	\$12,152	\$151,381
\$1M+ - \$5M	\$1,250,931	\$893,424	\$817,844	\$2,962,200
Over \$5M	\$3,156,002	\$1,509,658	\$0	\$4,665,659
Total	\$4,513,199	\$2,456,471	\$835,934	\$7,805,604
Surplus/(Deficit) Relative to FY 2019-20 Adopted Revenues				(\$6,762,379)

Table 2

Proposed Ordinance When Applied to FY 2020-21 Adopted Revenues				
Tiered and/or Marginal Tax Rates Based on Gross Receipts				
Adopted FY 2020-21 Revenues				\$15,733,167
Category	Retail	Cultivation & Manufacturing	Distribution & Transportation	Total
Up to \$500K	\$12,349	\$9,711	\$6,413	\$28,473
\$500K+ - \$1M	\$102,418	\$47,949	\$13,125	\$163,492
\$1M+ - \$5M	\$1,351,006	\$964,898	\$883,272	\$3,199,176
Over \$5M	\$3,408,482	\$1,630,430	\$0	\$5,038,912
Total	\$4,874,255	\$2,652,989	\$902,809	\$8,430,053
Surplus/(Deficit) Relative to FY 2020-21 Adopted Revenues				(\$7,303,114)

If the marginal tiered rates contemplated under the proposed Ordinance wherein the marginal tiered rates apply at each level of gross receipts were to be effective on January 1, 2020, the General Purpose Fund adopted revenues for FY 2019-20 and FY 2020-21 would decrease to \$7.81 million and \$8.43 million, respectively. **This would create a negative fiscal impact of approximately -\$6.76 million in FY2019-20 and -\$7.30 million in FY 2020-21 of the FY 2019-21 Adopted Policy Budget.** If the proposed rates were to be effective on January 1, 2021, only the second year of the Adopted FYs 2019-21 Policy Budget would be negatively impacted.

Proposed Ordinance Business Tax Structure, Effective on January 1, 2022

Proposed Oakland Cannabis Business Tax Structure*				
Total Gross Receipts	Cannabis Retail Businesses (including retail delivery)	Cannabis Manufacturing (including packaging and storage) and Cannabis Cultivation	Wholesale Distribution and Transportation (non-retail)	
Up to \$500,000 in gross receipts	.12% of gross receipts	.12% of gross receipts	.12% of gross receipts	Effective Jan. 2020 \ already enacted
Over \$500,000 up to \$1,000,000	.12% of gross receipts up to \$500,000 + 3% of gross receipts (over \$500,000)	.12% of gross receipts up to \$500,000 + 2.5% of gross receipts (over \$500,000)	.12% of gross receipts up to \$500,000 + 1.5% of gross receipts (over \$500,000)	Effective Jan. 2022
Over \$1,000,000 and up to \$5,000,000	3% of gross receipts up to \$1,000,000 + 4% of gross receipts over \$1,000,000	2.5% of gross receipts up to \$1,000,000 + 3.5% of gross receipts over \$1,000,000	1.5% of gross receipts up to \$1,000,000 + 2.0% of gross receipts over \$1,000,000	Effective Jan. 2022
Over \$5,000,000	4.5% of gross receipts up to \$5,000,000 + 5% of gross receipts over \$5,000,000	2.5% of gross receipts up to \$1,000,000 + 3.5% of gross receipts over \$1,000,000 and up to \$5,000,000 + 4.5% of gross receipts over \$5M	1.5% of gross receipts 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	Effective Jan. 2022
*No distinction between medical and non-medical (adult use); Cannabis Testing no longer taxed at Cannabis rate effective Jan. 2021.				

The proposed Ordinance contains a second tax structure that would become effective after the end of the transitional tax structure period on January 1, 2022. Thus, the existing tax structure would remain in place until first year of the FYs 2021-23 Biennial Policy Budget. Using a three percent (3%) inflation factor, **Table 3** below reflects the loss of additional ongoing revenues beginning in FY 2021-22.

Table 3

Marginal Tax Rate When Applied to FY 2021-22 Revenues				
Marginal Tax Rates Based on Gross Receipts				
(Rate effective January 2022) Forecasted FY 2021-22 Revenues				\$8,682,954
Category	Retail	Cultivation & Manufacturing	Distribution & Transportation	Total
Up to \$500K	\$21,529	\$19,547	\$11,744	\$52,821
\$500K+ - \$1M	\$283,550	\$187,774	\$114,579	\$585,903
\$1M+ - \$5M	\$1,504,794	\$851,412	\$313,744	\$2,669,950
Over \$5M	\$2,287,096	\$463,274	\$0	\$2,750,370
Total	\$4,096,969	\$1,522,007	\$440,067	\$6,059,043
Surplus/(Deficit) Relative to FY 2021-22 Forecasted Revenues				(\$2,623,911)

If the marginal tiered rates contemplated under the proposed Ordinance wherein the marginal rates apply at each level of gross receipts were to be effective on January 1, 2022, **the General Purpose Fund would experience an additional approximate decrease of -\$2.62 million of ongoing revenue.** The reason the loss of revenue is significantly less, is because the majority of the GPF revenue loss occurred in FYs 2019-20 and 2020-21. (Tables 1 & 2)

FISCAL IMPACT

The FY 2019-21 Adopted Policy Budget includes General Purpose Fund revenues derived from cannabis business activities of \$14.57 million in year one (1) and \$15.73 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 Adopted revenue for FY 2019-20 and FY 2020-21 would decrease revenues to \$7.80 million and \$8.43 million, respectively. This would create a negative fiscal impact of approximately -\$6.76 million in FY2019-20 and -\$7.30 million in FY 2020-21 of the FY 2019-21 Adopted Policy Budget.

Staff is recommending against the adoption of the proposed changes because of the negative financial impact of approximately -\$6.76 million in Fiscal Year (FY) 2019-20 and -\$7.30 million in FY 2020-21 of the FY 2019-21 Adopted Policy Budget and -\$2.62 million of ongoing revenue beginning FY 2021-22.

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 OPPORTUNITES

Economic: A reduction of tax rates would allow the City to stay on par with adopted or current tax rates 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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