



City of San Leandro

Meeting Date: February 18, 2020

Staff Report

File Number: 20-051

Agenda Section: ACTION ITEMS

Agenda Number: 10.A.

TO: City Council

FROM: Jeff Kay
City Manager

BY: Jeff Kay
City Manager

FINANCE REVIEW: Liz Warmerdam
Interim Finance Director

TITLE: Staff Report for a City of San Leandro City Council Resolution to Modify the Current Cannabis Business Tax Rate Schedule, Effective July 1, 2020

SUMMARY AND RECOMMENDATIONS

Per the direction of the City Council at the November 12, 2020 City Council work session, City staff presents the attached resolution that would modify the previously established cannabis business tax rate that was adopted on June 17, 2019. That rate is currently set at 6% of gross receipts, although it is scheduled to increase to 7% of gross receipts on July 1, 2020, and subsequently increase to 8% of gross receipts two years thereafter. If the proposed resolution is adopted, it would codify the following updated tax schedule, which would apply to any cannabis business, irrespective of whether it is associated with medicinal or adult use cannabis business activity in San Leandro, effective July 1, 2020:

- 5% of gross receipts for retail cannabis businesses (i.e. dispensaries)
- 3% of gross receipts for cannabis manufacturers
- 2% of gross receipts for cannabis laboratories and distributors

BACKGROUND

In November 2016, Measure NN (the "Cannabis Business Tax") was approved by a majority of San Leandro voters, enacting new cannabis business tax provisions as part of Chapter 2-21 of the Municipal Code. The City Council subsequently certified these election results on December 19, 2016. The provisions of the measure allow the City to impose a gross receipts tax on all businesses located within the City that use the cannabis plant as part of their business model, at a maximum rate of 10% of annual gross receipts. Measure NN does not legalize or otherwise permit cannabis businesses in San Leandro and the cannabis business tax is in addition to the cost of an annual business license, as well as the annual \$60,000 dispensary operating permit fee that is imposed to recover the City's costs in regulating cannabis dispensary businesses.

Prior to bringing Measure NN before the voters, City officials and staff declared during various public meetings and community events that the intention of the “up to 10%” language of the tax measure was meant to provide flexibility in the rate at which the tax would be imposed. Factors supporting such flexibility include:

- ensuring that local cannabis businesses maintain their competitiveness with other businesses operating in neighboring communities;
- recognition of the significant up-front costs associated with starting up a cannabis business; and
- ensuring that the cumulative federal, state, and local taxes imposed on such businesses would not serve to further incentivize the unregulated market.

Regional Context

Below is a list of the cannabis tax rates currently imposed in neighboring Bay Area communities, based on online research:

City of Alameda 0%

Berkeley 2.5% of gross receipts (medicinal)
5% of gross receipts (adult use)

Emeryville 3% of gross receipts (retail dispensaries and delivery)
2% of gross receipts (manufacturing)
1% of gross receipts (distribution & laboratory testing)

Hayward 6% of gross receipts

Oakland 0.12% of gross receipts (businesses with revenue < \$500K/year)

2020:
5% (medicinal),
6.5% (adult-use) [businesses w/ revenue of \$500K to \$5M/year]
9.5% (adult-use) [businesses w/ revenue >\$5M/year]

2021:
5% (adult-use) [businesses w/ revenue of \$500K to \$5M/year]
8% (adult-use) [businesses w/ revenue >\$5M/year]

2022:
4% [businesses w/ revenue of \$750K to \$1.5M/year]
5% [business w/ revenue >\$1.5M/year]

San Francisco 5% of gross receipts (retail businesses w/ revenue >\$1M/year)
2.5% of gross receipts (retail business with revenue <\$1M/year)
1.5% of gross receipts (non-retail >\$1M/year)

1% of gross receipts (non-retail < \$1M/year)

San Jose 10% of gross receipts

Santa Rosa 3% of gross receipts

Alameda County 0% (applies to unincorporated areas)

All three of San Leandro's permitted dispensary operators currently do business in jurisdictions referenced above that impose local gross receipts taxes. Additionally, each of San Leandro's three dispensary operators previously offered to provide voluntary gross receipts contributions to the City's General Fund as part of their business plan proposals when they first applied for dispensary permits several years ago. For example, the Davis Street Wellness Center (now known as NUG Wellness) voluntarily committed in writing to contribute 9% of its gross receipts to the City of San Leandro. In addition, Blum San Leandro offered to contribute 5% of its gross receipts to the City, and Harborside San Leandro committed to donating 4% of its gross receipts to a community benefits program fund, in addition to 1% gross receipts and 10% net revenue contribution to the City. All of the above-referenced voluntary contributions were ultimately nullified when San Leandro voters adopted Measure NN.

State and Federal Taxes

It is important to note that in addition to local gross receipts taxes, cannabis businesses throughout the State and region also face significant state and federal taxes as part of their operations. For example, Proposition 64 (which legalized the non-medical, adult use of cannabis statewide in the November 2016 election) established a 15% excise tax that is embedded into the retail sales price of cannabis. In addition, because the federal government still classifies cannabis as a Schedule I controlled substance, cannabis businesses are subject to higher federal taxes than other businesses. More specifically, Federal law 26 USC §280E (also known as "Rule 280E") arguably burdens the retail cannabis industry by disallowing certain standard business expense deductions. Therefore, their federal tax liability is greater than that of a non-cannabis business of similar size and annual revenues.

Conclusion

Based on the factors stated, and consistent with the City Council's direction at its November 12, 2019 work session, staff recommends modifying the tax rate in San Leandro. Although there was a spectrum of opinions expressed by the City Council members at the November work session, staff developed a modified rate structure that attempts to capture the general direction provided by a majority of the Council Members. The City Council retains the ability to further modify the proposed rates at its discretion.

Fiscal Impacts

Because only three cannabis dispensaries are presently operating in San Leandro and two of them have been open for less than one quarter, it is challenging to generate reliable General Fund revenue projections for the upcoming fiscal year. Assuming a 17% reduction in whatever revenue

would have otherwise been generated (i.e. the marginal difference in revenue generated between a 6% tax rate vs. the proposed 5% tax rate), it is conceivable the City could forgo approximately \$100,000 in revenue over the course of the upcoming fiscal year by reducing the cannabis tax rates. However, this estimated reduction in revenue could potentially be mitigated based upon several factors, including the specific future opening dates of the other cannabis businesses, and the potential for slightly increased sales volume that could be generated throughout the City because of a lower-tax environment for the cannabis industry. Such modified rates might also support the competitiveness of San Leandro-based cannabis companies and help support their long-term growth and financial success.

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City of San Leandro

Meeting Date: February 18, 2020

Resolution - Council

File Number: 20-060

Agenda Section: ACTION ITEMS

Agenda Number:

TO: City Council

FROM: Jeff Kay
City Manager

BY: Jeff Kay
City Manager

FINANCE REVIEW: Liz Warmerdam
Interim Finance Director

TITLE: RESOLUTION of the City of San Leandro City Council to Modify the Current Cannabis Business Gross Receipts Tax of 6% and replace it with the following schedule: 5% of gross receipts for retail cannabis businesses (i.e. dispensaries); 3% of gross receipts for cannabis manufacturers; 2% of gross receipts for cannabis laboratories and distributors

WHEREAS, on November 8, 2016, San Leandro voters authorized Measure NN (the Cannabis Business Tax), which established a new gross receipts tax on cannabis businesses that could be established by the City Council at a rate of up to 10%; and

WHEREAS, the results of the election were subsequently certified by the City Council on December 19, 2016; and

WHEREAS, on March 20, 2017, the City Council adopted a resolution establishing a gross receipts tax of 6% that is currently set to increase to 7% on July 1, 2020; and

WHEREAS, the City issued permits for three cannabis dispensaries, one cannabis manufacturing business, and one cannabis laboratory testing facility, consistent with the City's adopted cannabis regulatory ordinance and related San Leandro Zoning Code provisions; and

WHEREAS, in the interest of ensuring the success of these new businesses and recognizing that these businesses have significant up-front capital and tenant improvement costs as well as other significant state and federal tax obligations, the City Council desires to modify the current tax rate schedule; and

WHEREAS, the City Council recognizes that other communities in the region either adopted their own unique local cannabis tax rates, or chose not to implement such local taxes at all; the City Council also understands the importance of establishing local tax rates that will support the competitiveness of local San Leandro-based cannabis businesses; and

WHEREAS, based on these factors, the City Council desires to establish the following tax rate schedule, which would be applicable irrespective of whether the cannabis business is involved with medicinal or adult-use cannabis activity.

NOW, THEREFORE, the City Council of the City of San Leandro does RESOLVE as follows:

That said cannabis business tax rate is hereby set at: 5% of gross receipts for retail cannabis businesses (i.e. dispensaries); 3% of gross receipts for cannabis manufacturers; 2% of gross receipts for cannabis laboratories and distributors; and

That the City Manager is authorized to take all actions reasonably necessary to implement the directive and intent of this Resolution.