



CITY OF SALINAS COUNCIL STAFF REPORT

DATE: NOVEMBER 19, 2019

DEPARTMENT: FINANCE DEPARTMENT

FROM: MATT N. PRESSEY, CPA, FINANCE DIRECTOR

BY: KELLY MILLER, PLANNING CONSULTANT (RINCON CONSULTANTS)

TITLE: ORDINANCE REGARDING COMMERCIAL CANNABIS BUSINESS LICENSE TAX RATES

RECOMMENDED MOTION:

A motion to adopt an ordinance amending Salinas Municipal Code (SMC) Sec. 19A.10.070 repealing the scheduled automatic business license tax increase for commercial cannabis businesses (CCBs).

RECOMMENDATION:

Staff recommends that the City Council adopt an ordinance amending Salinas Municipal Code (SMC) Sec. 19A.10.070 repealing the scheduled automatic business license tax increase for CCB.

EXECUTIVE SUMMARY:

The current tax rate for CCB is scheduled to automatically increase on January 1, 2019. Staff is requesting the City Council repeal the scheduled tax increase because it may jeopardize what the City currently receives.

DISCUSSION:

Current and Scheduled Tax Rates for Commercial Cannabis Businesses

The City of Salinas collects a business license tax from the City's permitted CCBs. The following CCB types are taxed: cultivation, dispensary, delivery, and manufacturing.

Tax rates on CCBs were approved by Salinas Voters via Measure L on November 8, 2016. A "NO" vote was a vote against imposing a business tax on commercial cannabis businesses. A "YES" vote was a vote for establishing initial tax rates along with a scheduled increase after three years. Measure L passed with 74.18 percent "YES" votes. The measure was codified as Chapter 19A of the Salinas Municipal Code.

Pursuant to Section 19A.10.070, the City's current cannabis business tax rates are as follows:

Cultivation: \$15 per square foot of canopy area

Dispensary/ Delivery/ Manufacturing: 5% of gross receipts

The code has a scheduled automatic increase, which would be applied beginning January 1, 2020 and would establish the following increased rates:

Cultivation: \$25 per square foot of canopy area, then automatically adjusted, and adjusted annually, based on the Consumer Price Index

Dispensary/ Delivery/ Manufacturing: 10% of gross receipts

Considerations Regarding the Scheduled Tax Rate Increase

The commercial cannabis industry has grown steadily but slowly in Salinas throughout the past several years. Taxes and other industry-specific expenses are obstacles to entry and sustainability for prospective and operational CCB permit-holders. Industry-specific taxes and expenses for CCBs in Salinas include the following:

- 15% State excise tax
- State license fee (varies)
- Local taxes (described above)
- Application fee for a new permit: \$3,144.75
- Annual permit renewal fee: \$1,443.25
- Annual monitoring fees: between \$16,000 and \$27,000 (varies based on business type)

The expenses listed above are unique to the cannabis industry and are in addition to the normal expenses that any business faces, as well as other unique expenses such as the high level of product monitoring and security that is required of CCBs.

Staff has observed that the financial and regulatory challenges for CCBs have delayed the ability of some permitted businesses to commence commercial operations, and have challenged the ability of operational businesses to maintain viability. Furthermore, it is generally believed that throughout California the expenses associated with operating a legally compliant CCB have resulted in high product prices, which in turn sustains the illegal/black market despite the maturation of the legal adult-use (recreational) market.

While a substantial amount of regulatory expenses and taxes is inherent in the commercial cannabis industry, reasonable limits to these expenses should be maintained. Therefore, a repeal of the scheduled tax increase should be considered. As described below under Fiscal and Sustainability Impact, substantial tax revenue is already being collected at the current rates,

whereas a rate increase could potentially result in tax revenue reduction if some businesses are no longer able to remain compliant and profitable.

There is local precedent for adjusting tax rates to reduce the financial burden on CCBs. On July 24, 2018, Monterey County reduced the rate on cannabis cultivation per square foot of canopy area from \$15 to \$5 (for greenhouse grows) or \$8 (for indoor grows). Scheduled rate increases will reach a maximum of \$15 per square foot of canopy area. The County's rates for other cannabis business types currently range from three percent to four and a half percent, with scheduled incremental increases.

CEQA CONSIDERATION:

The proposed actions are not projects as defined by the California Environmental Quality Act (CEQA) (CEQA Guidelines section 15378).

DEPARTMENT COORDINATION:

The Finance Department coordinated with the Community Development Department and the City Attorney's Office on this report and recommendation.

STRATEGIC PLAN INITIATIVE:

The Commercial Cannabis pertains to the following City Council goals: 1: Economic Diversity and Prosperity; Goal 2: Safe, Livable Community; and Goal 3: Effective, Sustainable Government.

FISCAL AND SUSTAINABILITY IMPACT:

The table below shows tax revenue collected during 2018 and the first two quarters of 2019. Total revenue for 2019 is projected by doubling revenue collected during Quarter 1 (Q1) and Q2.

Commercial Cannabis Business Tax Collected 2018-19

<u>Q1 2018</u>	<u>Q2 2018</u>	<u>Q3 2018</u>	<u>Q4 2018</u>	<u>Q1 2019</u>	<u>Q2 2019</u>
120,736.87	143,838.70	328,894.12	276,979.18	332,421.50	352,270.40

2018 Total Tax Revenue: \$870,448.87

2019 Projected Total Tax Revenue: \$1,369,383.80

Taxes collected to date are all from dispensary, delivery, and manufacturing businesses, at the current rate of five percent of gross receipts¹. Based on the total projected tax revenue for 2019, the scheduled rate increase (to ten percent) would collect an additional \$1.3 million annually.

¹ Permits for cultivation have been issued but no cultivation business has commenced business operations as of the writing of this report

However, as described above, the rate increase could also have a reverse effect by impacting the viability of some operational businesses, and by preventing new applicants from pursuing business or successfully opening for business in the City. If the tax increase resulted in the closure of businesses that are paying the current rates, the rate increase could result in a net loss of tax revenue.

Salinas Municipal Code Description of Cannabis Tax Authority

City Council is authorized to amend or repeal the City's cannabis business tax. City Council may also, later, restore the rate of tax to any level not exceeding that described in Section 19A of the Salinas Municipal Code. Amendment and repeal of the City's cannabis business tax is governed by Section 19A.10.330, as follows:

This chapter may be repealed or amended by the City Council without a vote of the people. However, as required by Chapter XIII C of the California Constitution, voter approval is required for any amendment provision that would increase the rate of any tax levied pursuant to this chapter. The voters of the city affirm that the following actions shall not constitute an increase of the rate of a tax:

- a) The restoration of the rate of the tax to a rate that is no higher than that set by this chapter, if the City Council has acted to reduce the rate of the tax;
- b) An action that interprets or clarifies the methodology of the tax, or any definition applicable to the tax, so long as interpretation or clarification (even if contrary to some prior interpretation or clarification) is not consistent with the language of this chapter;
- c) The establishment of a class or person that is exempt or excepted from the tax or the discontinuation of any such exemption or exception (other than the discontinuation of an exemption or exception specifically set forth in this chapter); or
- d) The collection of the tax imposed by this chapter, even if the city had, for some period, failed to collect the tax.

ATTACHMENTS:

1. Ordinance

ORDINANCE NO. _____ (N.C.S.)

**AN ORDINANCE AMENDING THE MUNICIPAL CODE REGARDING
THE COLLECTION OF ASSESSMENTS FOR THE SALINAS UNITED
BUSINESS ASSOCIATION (SUBA) BUSINESS IMPROVEMENT AREA**

BE IT ORDAINED BY THE COUNCIL OF SALINAS as follows:

SECTION 1. Section 19A.10.070 of the Salinas Municipal Code is hereby amended as follows:

“19A.10.070. Amount of cannabis business tax owed.

(a) Every person whether it is a "not for profit", "a nonprofit" or a "non-profit organization" as defined in this section, or a for-profit entity who is engaged in a Commercial Cannabis Cultivation business in the city shall pay an annual cannabis business tax on medical marijuana and non-medical marijuana where it is permissible by both state and local law. The tax shall be set at a rate of fifteen dollars per square foot of canopy space utilized in connection with cultivation of marijuana. The tax rate may be increased by Resolution of the City Council up to twenty- five dollars per square foot. Beginning on January 1, 2021, and each succeeding year thereafter, the amount of each tax imposed by this section may be adjusted by Resolution of the City Council up to the equivalent to the most recent change in the annual average of the Consumer Price Index ("CPI") for all urban consumers in the San Francisco-Oakland-San Jose areas as published by the United States Government Bureau of Labor Statistics; however, no such adjustment shall decrease any tax imposed by this section.

The tax set forth in this subsection shall be applicable to all portions of a cultivation operation except nursery operations. Every person whether it is a "not for profit" or a "non-profit organization" as defined in this section, or a for-profit entity who is engaged in a commercial cannabis business in the city that is dedicated exclusively to a nursery operation shall pay an annual cannabis business tax on medical marijuana and non-medical marijuana, where it is permissible by both state and local law. Nursery operations shall be taxed at the rate of two dollars per square foot of canopy space utilized in connection with cultivation of marijuana. The tax rate may be increased by Resolution of the City Council up to five dollars per square foot. Beginning on January 1, 2021, and each succeeding year thereafter, the amount of each tax imposed by this section may be adjusted by Resolution of the City Council up to the equivalent to the most recent change in the annual average of the Consumer Price Index ("CPI") for all urban consumers in the San Francisco-Oakland-San Jose areas as published by the United States Government Bureau of Labor Statistics; however, no such adjustment shall decrease any tax imposed by this section. The city must be notified immediately if any portion designated as a nursery is converted to another use. If a subsequent inspection by the city or its representatives discovers that an area designated as nursery is in fact being used for other cultivation purposes, the cultivation business shall be responsible to pay the tax rates described in this section back to the previous city inspection, including any penalties and interest.

(b) Every person whether it is a "not for profit", "a nonprofit" or a non-profit organization" as defined in this section, or a for-profit entity who is engaged in business as a dispensary, delivery

service, or manufacturer of commercial Cannabis in the city shall pay an annual cannabis business tax on medical marijuana and non-medical marijuana where permissible by both state and local law. The tax shall be set at five percent of the gross receipts annually. The tax rate may be increased by Resolution of the City Council up to ten percent of the annual gross receipts.”

SECTION 2. Severability. If any section, subsection, sentence, clause, or phrase of this ordinance is for any reason held to be invalid or unconstitutional by a decision of any court of any competent jurisdiction, such decision shall not affect the validity of the remaining portions of this ordinance. The Salinas City Council hereby declares that it would have passed this ordinance, and each and every section, subsection, clause, and phase thereof not declared invalid or unconstitutional without regard to whether any portion of the ordinance would be subsequently declared invalid or unconstitutional.

SECTION 4. Effective Date. This Ordinance will take effect thirty (30) days from and after its adoption.

SECTION 4. California Environmental Quality Act. This ordinance is categorically exempt from the California Environmental Quality Act (CEQA) pursuant to Guidelines section 15061(b)(3). This exemption is allowed when the activity, in this case the recommendation of adoption of the ordinance, does not have the potential for causing a significant effect on the environment.

PASSED AND ADOPTED this _____ day of _____, 2019, by the following vote:

AYES:

NOES:

ABSENT:

ABSTAIN:

APPROVED:

Joe Gunter, Mayor

ATTEST:

Patricia M. Barajas, City Clerk

APPROVED AS TO FORM:

Christopher A. Callihan, City Attorney