



**CITY OF SALINAS
FINANCE COMMITTEE**

DATE: NOVEMBER 4, 2019

DEPARTMENT: FINANCE DEPARTMENT

FROM: MATT N. PRESSEY, CPA, FINANCE DIRECTOR

BY: KELLY MILLER, PLANNING CONSULTANT (RINCON CONSULTANTS)

TITLE: COMMERCIAL CANNABIS BUSINESS LICENSE TAXES

RECOMMENDED MOTION:

A motion to recommend that the City Council repeal a scheduled business license tax increase for commercial cannabis businesses (CCBs).

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 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.

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. 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, at a later date, 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 XIIC 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

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

- d) The collection of the tax imposed by this chapter, even if the city had, for some period of time, failed to collect the tax.

ATTACHMENTS:

- 1. None