TOWN COUNCIL STAFF REPORT

Subject: Workshop regarding cannabis tax ballot measure

Meeting Date: February 7, 2018

Written by: Rob Patterson, Administrative Services/Finance Director
Pam Kobylarz, Assistant to the Town Manager

RECOMMENDATION:

Staff is requesting Council direction on several items, including whether a maximum tax rate of 10% of gross receipts for retail cannabis businesses and 5% of gross receipts for cultivation, manufacturing and distribution cannabis businesses is appropriate, or whether some other type or amount of tax would be preferable.

BACKGROUND:

On November 8, 2016, the voters of California passed Proposition 64, which legalized the adult use of recreational marijuana. Beginning January 1, 2018, retail sales of recreational marijuana are legal. With the legal sales of marijuana, the State assesses a 15% excise tax. State and local sales taxes also apply. Local jurisdictions may approve an additional local tax on cannabis businesses.

Because the Town Council has previously expressed support for a local cannabis tax, Town staff contracted with Hinderliter, de Llamas & Associates (HdL) to conduct an analysis for a proposed tax.

Two types of taxes may be approved by the voters. A general tax must be approved by a majority of those voting. Any revenues the Town receives from a general tax must go into the general fund and may be used for any purpose. General taxes may only be placed on the ballot at the same time as the Town Council is elected. The next opportunity to place a general tax on the ballot is June 5, 2018; after that, the next opportunity would be June 2020. A special tax may be placed on the ballot at any time, and the proceeds of such a tax may be designated for specific purposes. A special tax must pass by a two-thirds vote. Town staff recommends that any cannabis tax ballot measure be a general tax placed on the June 5, 2018 ballot.

ANALYSIS:

HdL has conducted an analysis of a variety of different scenarios and tax options to give the Council a sense of the revenues that could potentially be expected with different tax rates. Since the gross receipts of cannabis businesses are unknown at this time, these numbers are educated guesses based on HdL’s extensive experience.

Because there are so many unknowns related to the success of cannabis businesses and what the appropriate tax rate may be, staff recommends that the Council support placing a maximum rate for the tax on the ballot, rather than a specific rate. The voters would approve the maximum tax rate and the Town's ordinance would regulate the details regarding how the tax is implemented. The ordinance could also give the Council the ability to collect the tax at a rate lower than the maximum rate approved by the voters, perhaps with a minimum rate. Staff recommends structuring the tax as a gross receipts tax on cannabis businesses, with a maximum rate of 10% for retail businesses and 5% for cultivation, manufacturing and distribution businesses.

In addition to the analysis conducted by HdL, staff has analyzed cannabis tax rates in other municipalities (see Attachment B). Each of the municipalities analyzed approached the taxes slightly differently.

- Retail sales: each agency established a range, starting at between 2-5% and going up to 10-12.5%.
- Cultivation and Nursery: Some agencies based the tax on canopy area of cultivation businesses, with the tax assessed at a specific dollar amount per square foot of canopy, while others opted to tax the gross receipts. Agencies that have taxed canopy area have charged between $3.75 and $15 per square foot.
- Manufacturing and Testing: each agency established a range, starting at between 3-5% and going up to 10-12.5%.
- Distribution: each agency established a range, starting at between 0-5% and going up to 10-12.5%.

Similar to what other agencies have approved, the Council may want to start the tax at a relatively low rate. This can be addressed in the ordinance by specifying the rate at a given time, and could be the same or could vary for different types of businesses. However, the most flexible approach would simply be to ask the voters to approve a maximum tax rate, and perhaps a minimum rate, and leave it to the Council to decide where in that range the tax should be at any given time.

<u>Council direction and next steps</u>

Staff is requesting direction from the Council at today's meeting in order to draft the ballot language and ordinance to meet the deadline for the June 5, 2018 election. Staff would like direction from the Council on the following items:

- Should cultivation businesses be taxed at a rate per square foot of canopy or by gross receipts? If a rate per square foot is preferred, what should that rate be?
- If a gross receipts tax is preferred for cultivation, does a maximum tax rate of 10% for retail and 5% for cultivation, manufacturing and distribution cannabis businesses give the Town enough flexibility to adapt to changes in the cannabis industry and address the Town's needs over time? If not, what range would be more appropriate?
- Does the Council wish to have the ordinance that goes to the voters establish a starting tax rate, or would the Council prefer to establish that later? If the voters

are going to be asked to approve one or more initial tax rates for the various business types when the tax goes into effect, what should that rate or rates be?

- Do we want to establish annual maximum rate increases for each respective tax?

Staff will use the direction from today's meeting to prepare ballot measure language. Along with several administrative actions, this will be presented to the Council for consideration at the February 21, 2018 meeting. Due to the timing of the election and state mandated deadlines, the Council will need to take action on February 21st in order to get this item on the ballot.

STAFFING CONSIDERATIONS:

Impacts to staff workload will be minimal. The Town has a contract in place for HdL to conduct annual audits of cannabis businesses, which will be paid for by the businesses.

FINANCIAL CONSIDERATIONS:

There are no specific financial considerations related to the placement of a tax measure on the ballot. The Town already splits the cost of the election with the County because of the Town Council election.

The passage of a cannabis tax by the voters could result in new revenue for the Town. Anticipated revenues are unknown at this time and would be dependent on the amount of the tax and gross receipts of the cannabis businesses.

ENVIRONMENTAL CONSIDERATIONS:

None.

LEGAL CONSIDERATIONS:

None.

Attachments:

A. HdL Analysis
B. Spreadsheet comparing cannabis tax rates in other municipalities

Cumulative Cannabis Taxes			
Category	Amount	Increase	Cumulative Price
Producer Price	$800	$800	$800
State Cultivation Tax	$9.25/oz	$148	$948
Local Tax	1.00%	$8	$956
Batch Testing	$50/lb, + 0.50%	$55	$1,011
Wholesale Price w/ Taxes		$1,011	
Total Tax at Wholesale		$211	
Tax as %		26.38%	
Manufacturer Markup	20.00%	$202	$1,213
Local Tax	2.50%	$30	$1,244
Total Manufacturer Price		$1,244	
Total Taxes at Manufacturer		$241	
Total Tax as %		19.41%	
Distributor Markup	30.00%	$373	$1,617
Local Tax	2.00%	$32	$1,649
Total Distributor Price		$1,649	
Total Taxes at Distributor		$274	
Total Tax as %		16.60%	
Retailer Markup	100.00%	$1,649	$3,298
Local Tax	4.00%	$132	$3,430
State Excise Tax	15.00%	$495	$3,924
Total Retailer Price		$3,924	
Total Taxes at Retail		$900	
Total Tax as %		22.94%	
CA Sales Tax	6.75%	$265	$4,189
Local Sales Tax	1.00%	$39	$4,229
Total Taxes at Retail		$1,204	
Total Tax as %		28.48%	
Total Local Tax		5.72%	$241.82

Mammoth Lakes Tax Analysis 2/1/2018

Cultivation Permits	Total 3			Tax Scenarios		
	Total Sq Ft		Total Sq Ft	$1	$2	$3
Permit 1	2500	1	2500	$2,500	$5,000	$7,500
Permit 2	5000	1	5000	$5,000	$10,000	$15,000
Permit 3	5000	1	5000	$5,000	$10,000	$15,000
				$12,500	$25,000	$37,500

Delivery Permits	Up to 0			Tax Scenarios		
	Gross Receipts		Total GR	4%	5%	6%
Scenario 1	$0	0	$0	$0	$0	$0
Scenario 2	$0	0	$0	$0	$0	$0
Scenario 3	$0	0	$0	$0	$0	$0

Manufacturing Permits	Up to 3			Tax Scenarios		
	Gross Receipts		Total GR	2.5%	3%	4%
Scenario 1	$1,500,000	1	$1,500,000	$37,500	$45,000	$60,000
Scenario 2	$1,500,000	2	$3,000,000	$75,000	$90,000	$120,000
Scenario 3	$1,500,000	3	$4,500,000	$112,500	$135,000	$180,000

Mammoth Lakes Tax Analysis

2/1/2018

Retailer Permits		Up to 2		Tax Scenarios		
	Gross Receipts		Total GR	4%	5%	6%
Scenario 1	$1,000,000	2	$2,000,000	$80,000	$100,000	$120,000
Scenario 2	$1,000,000	2	$2,000,000	$80,000	$100,000	$120,000
Scenario 3	$1,000,000	2	$2,000,000	$80,000	$100,000	$120,000

Distribution Permits		Up to 3		Tax Scenarios		
	Gross Receipts		Total GR	2%	3%	4%
Scenario 1	$1,500,000	1	$1,500,000	$30,000	$45,000	$60,000
Scenario 2	$1,500,000	2	$3,000,000	$60,000	$90,000	$120,000
Scenario 3	$1,500,000	3	$4,500,000	$90,000	$135,000	$180,000

Testing Lab Permits		Up to 1		Tax Scenarios		
	Gross Receipts		Total GR	1.00%	1.25%	1.50%
Scenario 1	$1,000,000	1	$1,000,000	$10,000	$12,500	$15,000
Scenario 2	$1,000,000	1	$1,000,000	$10,000	$12,500	$15,000
Scenario 3	$1,000,000	1	$1,000,000	$10,000	$12,500	$15,000

Max Permits	Total of 12	
	Conservative	$305,000
	Aggressive	$407,500
	Very Aggressive	$532,500
Mid Permits	Total of 10	
	Conservative	$237,500
	Aggressive	$317,500
	Very Aggressive	$412,500
Min Permits	Total of 8	
	Conservative	$170,000
	Aggressive	$227,500
	Very Aggressive	$292,500

Agency	Ballot Measure	Retail	Cultivation	Manufacturing	Testing	Distribution	Delivery	Nursery
Town of Mammoth Lakes	Proposed by staff: Retail sales - maximum of 10% gross receipts All other businesses - maximum of 5% gross receipts	TBD	TBD	TBD	TBD	TBD	Use is not proposed at this time. (Any tax would be consistent with retail sales)	TBD
	All taxes imposed on a monthly basis							
		Max of 10% gross receipts	Max of 5% of gross receipts	Max of 5% of gross receipts	Max of 5% of gross receipts	Max of 5% of gross receipts	N/A	Max of 5% of gross receipts
Inyo County (Ballot Measure 11/2016)	5% on cannabis businesses (no less than $1,250 per growing cycle for cultivation), NTE 12.5% over time	5% gross receipts per FY for period of 1/1/2017 - 6/30/2020	5% of gross receipt per fiscal year; ≤ 2,500 sf cannabis shall pay no less than $1,250 per growing cycle; 2,500 - 5,000 sf cannabis shall pay no less than $2,500 per growing cycle; > 5,000 sf cannabis shall pay no less than $5,000 per growing cycle	5% gross receipts per FY for period of 1/1/2017 - 6/30/2020	5% gross receipts per FY for period of 1/1/2017 - 6/30/2020	5% gross receipts per FY for period of 1/1/2017 - 6/30/2020	5% gross receipts per FY for period of 1/1/2017 - 6/30/2020	5% gross receipts per FY for period of 1/1/2017 - 6/30/2020
	All taxes imposed on a FY basis and collected quarterly							
	On 7/1/2020	Tax may be increased in 2.5% increments, NTE a max. of 12.5% per FY on gross receipts; Increase can occur once per FY, following approval from the BOS	Tax may be increased in 2.5% increments, NTE a max. of 12.5% per FY on gross receipts; Increase can occur once per FY, following approval from the BOS	Tax may be increased in 2.5% increments, NTE a max. of 12.5% per FY on gross receipts; Increase can occur once per FY, following approval from the BOS	Tax may be increased in 2.5% increments, NTE a max. of 12.5% per FY on gross receipts; Increase can occur once per FY, following approval from the BOS	Tax may be increased in 2.5% increments, NTE a max. of 12.5% per FY on gross receipts; Increase can occur once per FY, following approval from the BOS	Tax may be increased in 2.5% increments, NTE a max. of 12.5% per FY on gross receipts; Increase can occur once per FY, following approval from the BOS	Tax may be increased in 2.5% increments, NTE a max. of 12.5% per FY on gross receipts; Increase can occur once per FY, following approval from the BOS
Davis (Ballot Measure 6/2016) Medical Only	Up to 10% gross receipts on non-medical (recreational) cannabis businesses	10% gross receipts	10% gross receipts	5% for gross receipts of < $50k/mth 4% for gross receipts of $50k - $100k/mth 3% for gross receipts of > $100k/mth	5% for gross receipts of < $50k/mth 4% for gross receipts of $50k - $100k/mth 3% for gross receipts of > $100k/mth	10% gross receipts	10% gross receipts	10% gross receipts
Sonoma County (Ballot Measure March 2017) Medical Only	Up to $38 per sf for indoor cultivation; up to 10% gross receipts per FY	2% gross receipts	Canopy area: ≤ 500 sf = $3.75 / sf; 501 - 5,000 sf = $7.50 / sf; 5,001 - 10,000 sf = $11.25 / sf 10,001 - 22,000 sf = $11.25 / sf	3% gross receipts	0% gross receipts	0% gross receipts	2% gross receipts	0% gross receipts
	All taxes imposed on a FY basis and collected quarterly							
	On 7/1/2019	Max of 10% gross receipts	Max of $38 per sf, based on CPI increase	Max of 10% gross receipts	Max of 10% gross receipts	Max of 10% gross receipts	Max of 10% gross receipts	Max of 10% gross receipts
Monterey County		5% gross receipts	$15/sf of canopy per FY	5% gross receipts	5% gross receipts	5% gross receipts	5% gross receipts	$2/sf of canopy per FY
		All taxes imposed on a FY basis and collected quarterly						
	On 7/1/2020	Increase 2.5%, NTE 10% per FY	Increase $5/SF each FY until it reaches $25/sf	Increase 2.5%, NTE 10% per FY	Increase 2.5%, NTE 10% per FY	Increase 2.5%, NTE 10% per FY	Increase 2.5%, NTE 10% per FY	Increase $1.50/sf each FY until it reaches $5/sf
	On 7/1/2022		Increased by change in the average CPI					Increased by change in the average CPI