



**DATE:** March 6, 2018

**TO:** Mayor and City Council

**FROM:** Director of Finance and City Attorney

**SUBJECT** Introduction of an Ordinance and Resolution for Taxation of Adult Use Cannabis

### **RECOMMENDATION**

That the City Council:

1. Introduces the attached ordinance relating to a Commercial Cannabis Tax, (**Attachment II**); and
2. Reviews and provides direction regarding the proposed resolution establishing the Commercial Cannabis Tax rate (**Attachment III**).

### **SUMMARY**

City staff is proposing introduction of an ordinance establishing the procedure for levying and collecting the Commercial Cannabis Tax approved by the passage of Measure EE. Additionally, staff seeks direction regarding a proposed resolution to establish the Commercial Cannabis Tax rate at 6% of gross sales.

### **BACKGROUND**

On November 8, 2016, the voters of the City of Hayward approved Measure EE authorizing the City Council to enact an ordinance imposing a general tax of up to 15% of gross sales of medicinal cannabis and adult use cannabis and products derived therefrom. This tax is in addition to any other taxes imposed by the City of Hayward or the State of California. Prop. 64 and its trailer legislation established two distinct state taxes on the cannabis industry.

Statewide, a cultivation tax will be imposed on all harvested cannabis that enters the commercial market at the rate of \$9.25/dry weight ounce for flowers and \$2.75/dry weight ounce for leaves. The state will also impose an excise tax on cannabis and cannabis products sold in California at the rate of 15% of the average market price of any retail sale by a cannabis retailer.

On the same date that Prop. 64 was approved, the voters of Hayward approved Measure EE authorizing the City to impose a local tax not exceeding fifteen percent (15%) of gross sales of adult use of recreational and medical cannabis. The tax may be applied to cultivation, distribution, manufacturing, business-to-business sales, as well as retail sales.

On October 30, 2017, City Council provided feedback and direction [during a work session](#) regarding the imposition of the Measure EE Cannabis Tax rate.

## **DISCUSSION**

City officials and staff have expressed that the intention of the “up to 15%” language was to provide flexibility for the rate at which the tax would be imposed. Factors supporting such flexibility include:

- Ensuring that local cannabis businesses maintain their competitiveness with other neighboring communities and
- Ensuring that the cumulative federal, state, and local taxes imposed on such businesses would not inadvertently incentivize an underground market for cannabis.

There are many taxes applicable to adult-use cannabis businesses including:

### State and Federal Taxes

Proposition 64, which legalized the non-medical use of cannabis statewide as part of the November 2016 election, included a 15% excise tax that will be imposed on the retail sales price of cannabis. In addition, because the federal government still classifies cannabis as a Class I controlled substance, cannabis businesses are subject to higher federal taxes than other businesses. More specifically, Federal law 26 USC §280E (Rule 280E) arguably burdens the cannabis industry by disallowing standard business expense deductions. Traditionally, non-cannabis companies may legally deduct from gross sales nearly all their costs of goods sold and their business expenses. Costs of goods sold are the direct costs attributable to the production of the goods sold. For a cannabis business, this amount includes the costs of the materials used in creating the good, along with the direct labor costs used to produce the good. The expenses would be advertising, professional services, and office supplies to name a few. However, because of Rule 280E, cannabis businesses are disallowed from taking deductions from gross sales for business expenses, other than cost of goods. Therefore, their federal tax liability will be greater than that of a non-cannabis business of a comparable size and annual revenues.

### Local Sales Taxes

In Alameda County, the sales tax rate is 9.25%.

## Cannabis Tax Rates in Alameda County

Different jurisdictions in Alameda County have set their cannabis tax rates at a range of levels. A detailed summary of tax rates and regulations for other Alameda County cities is in **Attachment IV**.

- Oakland: Taxes recreational cannabis at 10% of gross receipts
- San Leandro: Measure NN approved in November 2016 was a voter-approved gross receipts tax on cannabis businesses of up to 10%. It is currently 6% and will increase to 8% by 2021. All cannabis businesses must have annual audits.
- Emeryville: Is currently considering setting a tax rate for recreational cannabis
- Berkeley: On 2/13/18, Berkeley amended their tax rate from 10% to 5% for recreational cannabis.

## Other Jurisdictions

Many jurisdictions in California are in process of establishing their respective tax rates. Below is a summary of comparable jurisdictions and what they are implementing:

- Santa Rosa: 2% of gross receipts for cultivation, 1% of gross receipts for manufacturing, and 3% for adult use retail dispensaries
- Unincorporated Sonoma County: 3% of gross receipts for manufacturing, 2% of gross receipts for dispensaries
- San Jose: 10% of gross receipts

At the October 30, 2017 work session, Council expressed a preference for 5% of gross sales for cultivating and manufacturing and 8% for retail sales dispensaries. Staff recommends that the Council impose a rate of 6% gross sales. This enables the City to develop a tax that is simple to administer, audit, and encourages industry to operate legally and not in the black market. Additionally, this proposed tax rate reduces the impact of tax layering and provides certainty and clarity around the tax rate.

The proposed ordinance, as authorized by Measure EE, codifies procedures for levying and imposing the Commercial Cannabis Tax. The tax rate may be set by resolution or ordinance. However, the City Council may not impose a rate which exceeds the maximum rate authorized by the voters or change the methodology for calculating the tax. If the rate is set by resolution, the resolution must be published in the same manner and in the same time as an ordinance.

## **STRATEGIC INITIATIVES**

This agenda item supports the Complete Communities Strategic Initiative. The purpose of the Complete Communities Strategic Initiative is to create and support structures, services and amenities to provide inclusive and equitable access with the goal of becoming a thriving and promising place to live, work and play for all. The item supports the following goal and objective:

Goal 3: Develop a Regulatory Toolkit for Policy Makers

Objective 3: Develop and refine other regulatory tools

### **FISCAL IMPACT**

On October 14, 2017, the Council held a Fiscal Sustainability Workshop in which it considered strategies and options to shape the City's long-term fiscal future. One of the strategies presented and discussed in the session and staff report for this meeting were possible revenues generated from the cannabis tax approved by Measure EE. The City partnered with Management Partners to research many of the strategies presented; Management Partners estimated gross annual tax receipts of approximately \$2.1 million. This amount was calculated on a per capita number from San Jose (gross tax receipts/the number of residents), which came up with \$9.02 per capita. Related to the City of Hayward, staff multiplied \$9.02 by the number of residents and then multiplied the per capita by 1.5 to recognize the difference in rates (as presented at 15%). Staff estimates these revenues to be between \$1 and \$3 million annually depending on the tax rate applied, number of businesses, how the tax is applied, and which types of operations the tax will apply to.

### **PUBLIC CONTACT**

The Council held work sessions regarding cannabis businesses in Hayward in March, July, and October 2017 and introduced ordinances establishing a local regulatory framework for cannabis businesses on October 17, 2017.

### **NEXT STEPS**

After introduction of the tax ordinance, subject to any amendments made by the Council, the tax ordinance and a finalized resolution imposing the specific tax rate will be placed on the agenda for the next City Council meeting for adoption.

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Approved by:



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