



DATE: October 29, 2019

TO: Mayor and City Council

FROM: City Manager

SUBJECT: Introduction of an Ordinance Increasing the Commercial Cannabis Tax Rate to 7% of Gross Sales

RECOMMENDATION

That the City Council introduces an ordinance amending Section 8-21.11 of Article 21, Chapter 8 of the Hayward Municipal Code, increasing the Commercial Cannabis Tax rate from 6% to 7% of gross sales (Attachment II).

SUMMARY

In November 2016, 60% of Hayward voters approved Measure EE, establishing a general tax of no more than 15 percent of gross receipts for all products associated with medical or adult use of cannabis. As a general tax, Measure EE revenue may be used for any municipal purpose. In March 2018, the City Council initially set the Measure EE tax rate at 6% of gross receipts.

Since January 2018, the City has issued Commercial Cannabis Permits to 23 cannabis businesses. The Commercial Cannabis Permit program requires future cannabis businesses to submit, via a request for proposals, a business proposal that outlines a business plan, management experience, safety and security plans, and several other business components. Proposers had to also outline community benefits each business would provide to the City as a condition of being approved to operate.

BACKGROUND

In November 2016, 60% of Hayward Voters approved Measure EE, establishing a general tax of no more than 15 percent of gross receipts for all products associated with medical or adult use of cannabis. The ballot materials stated that revenue from the tax would be deposited in the City's general fund and could be used for any valid municipal purpose, including police and fire services, paramedic services, youth and anti-gang programs, disaster preparedness, economic development, street repairs and maintenance, graffiti removal, and code enforcement. In March 2018, the City Council initially set the Measure EE tax rate at 6% of gross receipts.

In October 2017, the City Council adopted Ordinance 17-13, adding Article 14 to Chapter 6 of the Hayward Municipal Code¹, which established a request for proposals process by which the City selects commercial cannabis businesses following the scoring and evaluation of business proposals. Each proposal discloses, for evaluation, a business plan that provides details of relevant management experience, a conceptual safety and security plan, and several other operational and business components including, but not limited to, a community benefits program that each business has committed to the Hayward community as a condition of being approved to operate.

To date, the City has conditionally issued Commercial Cannabis Permits to a total of 23 businesses spanning the cannabis supply chain, including manufacturing, distribution, delivery, testing labs, cultivation, and retail dispensaries. Following Council approval, each applicant is then required to obtain the necessary land use entitlements and required to implement various components of their business proposal, including their community benefits program, prior to and following the issuance of any license to ensure that all necessary conditions of approval are met.

Several businesses stated in their proposals that remitting the Measure EE tax provided the City with a community benefit. Other approved businesses proposed making cash donations of varying amounts to area non-profits as a community benefit. Leaving the distribution of donations to the discretion of cannabis businesses may not lead to community benefits that are consistent or reflective of the City Council's priorities or that address the most pressing needs of the Hayward community.

The City has created a Hayward Community Foundation (HCF), in part, to partner with these approved businesses to ensure the relevant, equitable, and impactful use of any community benefit donations. Additionally, the HCF could assist local area non-profits by reducing their operating and administrative overhead costs through the creation of individual funds to support each specific non-profit. On March 19, 2019, the City Council authorized the City Manager to establish an affiliate fund with the East Bay Community Foundation, the first step in creating the Hayward Community Foundation (HCF).

DISCUSSION

Staff recommends that the Council increase the Measure EE tax rate to 7% for the purpose of increasing general revenue for the City. Measure EE tax revenue may be available for expenditure for any and all municipal purposes. Revenue collected from the tax is deposited in the General Fund for future appropriation.

In future budget cycles, the Council may appropriate, allocate and authorize General Fund revenue derived from Measure EE to, among other things, the HCF to facilitate the provision of community services such as youth programs, educational programs, etc. The amount of this appropriation may vary from year to year, depending on community need as

¹ Commercial Cannabis Businesses:
https://library.municode.com/ca/hayward/codes/municipal_code?nodeId=HAYWARD_MUNICIPAL_CODE_CH6BUPRTR_ART14COCABU

determined by the Council. Staff will make appropriation and allocation recommendations for Measure EE revenue during the annual budget cycle process. Separate from any Measure EE tax revenues contributed to the HCF, the Council will ultimately need to develop a distribution mechanism for any funds accumulated in the HCF. At this time, staff recommends that funds be deposited into the HCF until the fund balance reaches \$1,000,000, at which point staff will return for direction on a funding allocation process.

In addition, review of the community benefits requirement as part of the cannabis permitting process will occur consistent with the recommendations in the other cannabis related legislative business item on this evening's Council agenda. Setting the tax rate at 7% now will ensure that currently permitted cannabis businesses will allow the City to provide funds for general government services, including community services, until a more comprehensive review of the cannabis program can be completed.

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

- Oakland: Cannabis businesses with gross receipts of less than \$500,000 pay a tax of .12% of gross receipts. For businesses with gross receipts of more than \$500,000 annually pay a tax of 5% for medical sales and 10% for recreational sales.
- 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 2022. All cannabis businesses must have annual audits.
- Emeryville sets cannabis taxes based on business type:

- Testing: 1% of gross receipts
- Distribution: 1% of gross receipts
- Manufacturing: 2% of gross receipts
- Delivery: 3% of gross receipts
- Storefront Retail: 3% of gross receipts
- Berkeley: On 2/13/18, Berkeley amended their tax rate from 10% to 5% for adult use cannabis.

Article 8, Chapter 21 of the Hayward Municipal Code codifies procedures for levying and imposing the voter-approved Measure EE Commercial Cannabis Tax. The tax rate may be set by resolution or ordinance. However, the City Council may not impose a rate that exceeds the maximum rate authorized by the voters (15%) 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. In this case, the tax rate will be increased by adoption of an ordinance and is proposed to be increased from 6% to 7%.

ECONOMIC IMPACT

Measure EE tax revenue may be used for any municipal purpose, including but not limited to, police and fire services, or graffiti abatement. Measure EE tax revenue may also be allocated from the General Fund to the Hayward Community Foundation which could utilize this funding to support non-profit organizations or other social programs, catalyzing community prosperity through grants to various individuals, community groups, and organizations. Furthermore, non-profit community foundations provide corporations and individuals access to tax advantages like the federal charitable giving tax deductions.

FISCAL IMPACT

The proposed tax increase has no anticipated fiscal impact on the City but may result in additional revenues to the City's General Fund when cannabis businesses ultimately begin operations.

STRATEGIC INITIATIVES

This agenda item supports the Complete Communities strategic initiative. The purpose of the Complete Communities 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. Specifically, this item supports the following goal:

- Goal 1: Improve quality of life for residents, business owners, and community members in all Hayward neighborhoods.

NEXT STEPS

If the City Council adopts the proposed ordinance, the Commercial Cannabis tax rate will be increased from 6% to 7% of gross receipts. Pursuant to the Charter, the tax increase will take effect immediately upon adoption. Staff will propose an allocation of any Measure EE funds as part of the annual General Fund budget adoption process.

Separately from the Measure EE increase, staff will monitor the accumulation of funds in the Hayward Community Foundation. Once the fund balance reaches \$1 million, staff will return to the City Council for a work session on proposed funding allocation process.

Prepared by: Monica Davis, Community Services Manager

Recommended by: Jennifer Ott, Deputy City Manager

Approved by:

A handwritten signature in black ink, appearing to read 'K. McAdoo', written over a horizontal line.

Kelly McAdoo, City Manager