

CITY OF LOS ANGELES
INTER-DEPARTMENTAL CORRESPONDENCE

Date: October 24, 2016

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Council File No. 14-0366-S5
Council District: All

To: Rules, Elections, Intergovernmental Relations, and Neighborhoods Committee

From: Miguel A. Santana, City Administrative Officer 

Subject: **MARIJUANA REPORT BACK #4 – ANALYSIS OF TAX RATES FOR MARIJUANA-RELATED BUSINESSES (C.F. 14-0366-S5)**

During its consideration of a joint report from the Offices of the City Administrative Officer (CAO) and the Chief Legislative Analyst (CLA) dated August 18, 2016 regarding options to regulate marijuana-related businesses within the City (C.F. 14-0366-S5), the Rules, Elections, Intergovernmental Relations, and Neighborhoods Committee requested the CAO to provide an analysis of tax rates for marijuana-related businesses (MRBs).

Any imposition of new taxes or an increase in existing taxes will require a ballot measure. Proposition (Prop) D increased the City's gross receipts tax on medical marijuana businesses from five percent (5%) to six percent (6%). If the City wishes to address the gross receipts taxes for marijuana businesses covered under the Medical Marijuana Regulation and Safety Act (MMRSA) and the Adult Use of Marijuana Act (AUMA), the City could draft a ballot measure that would:

- expand the existing tax to cover all marijuana businesses;
- propose a new tax on marijuana businesses not covered under Prop D;
- propose a series of new taxes for different types of marijuana businesses; or,
- propose an increase to the existing tax and expands the tax to cover all marijuana businesses.

Attachment 1 provides a summary of the marijuana taxes adopted in other California cities.

It is important to note that the state election will be held on November 8, 2016 and the Council would need to act on requesting the City Attorney to prepare a ballot measure for the May 2017 election upon learning the results of Prop 64. The table below outlines the important dates associated with the March 2017 election cycle.

<u>Election Date</u>	<u>Last Day for Committee Action</u>	<u>Last Day to Request City Attorney to Prepare Election Resolution(s)</u>	<u>Last Day for Council to Adopt Election Resolution(s)</u>
May 16, 2017 (General)	December 9, 2016*	January 11, 2017**	January 25, 2017

* Date shown is a Special meeting, due to Council recess in December 2016.

** This is the legal deadline. For purposes of practicality, Council may wish to make this request at an earlier date to allow sufficient time for preparation of the Election Resolution(s).

REVENUE ENHANCEMENT

As previously discussed, any imposition of new taxes or an increase in existing taxes will require a ballot measure. State-approved medical and recreational marijuana sales nationwide equaled \$2.7 billion in 2014, \$5.4 billion in 2015, are expected to reach \$6.7 billion in 2016, and could reach \$21.8 billion by 2020. California's medical marijuana sales already account for a large portion of the total sales. If California legalizes recreational marijuana in November, it is predicted to result in a significant increase in regulated marijuana sales.

Other States Imposing Marijuana Taxes

Colorado imposes a 15 percent tax on wholesale marijuana price plus 10 percent state tax on marijuana sales price. In addition to the state tax, the City of Denver imposes two tax rates: (1) a standard sales tax rate of 3.62 percent and (2) a voter approved special tax of 3.5 percent. In 2014, Denver collected \$12.65 million in new tax revenue on \$148.8 million in retail sales.

Oregon imposes a tiered sales tax structure, up to 25 percent, on recreational marijuana sales. Concerned over the practical enforceability of such a tax system, the tax will eventually be replaced with a flat 17 percent state tax once the Oregon Liquor Control Commission assumes control over recreational marijuana sales later this year. Municipalities are able to impose an additional 3 percent tax.

Washington imposes a 37 percent excise tax on the retail marijuana sales, plus the state Business & Occupation (B&O) gross receipts tax, plus the state sales tax of 6.5 percent, plus local sales taxes. The 37 percent excise tax replaces the earlier, more complicated tax structure: a 25 percent tax on producer sales to processors, another 25 percent tax on processor sales to retailers, and a further 25 percent tax on retailer sales to customers. In Seattle (9.5% local tax), the effective tax rate is approximately 54 percent. This compares to a 104 percent effective tax rate on cigarettes.

Key Findings from Other States

- Marijuana tax collections in Colorado and Washington exceeded initial estimates.
- Colorado, Washington, and Oregon have all modified their initial marijuana tax rates. Recent ballot initiative proposals have proposed rates between 10 and 25 percent.
- Tax rates on final retail sales have been the most effective form of taxation. Other forms of taxation, such as taxing marijuana flowers at a certain dollar amount, taxing at the wholesale level rather than the retail level, or taxing products by their level of THC, have proven difficult to implement and enforce.
- Medical marijuana is usually more loosely regulated and taxed less than recreational marijuana. In Washington, limiting non-medical sales to the retail market has been difficult given the differentials in tax rates and regulatory structure. Washington officials wished the two systems had been tackled simultaneously.

- Revenue can be in the tens or even hundreds of millions of dollars, cash management practices, storage, and general cash flow management strategies require lead time to develop and successfully implement.
- Revenues start out slowly until retailers and consumers became familiar with the new frameworks and regulatory infrastructure.
- Significant attention must be given to local enforcement, public safety, health, zoning, local enforcement, agricultural, and criminal penalty issues. These important issues have generally been unaddressed in ballot initiatives and left for resolution in the implementation process.

Recreational Marijuana Tax Rates by State

State	Marijuana Tax	Other Taxes
Colorado	15 percent tax on wholesale marijuana price plus 10 percent state tax on the retail marijuana sales price. 10 percent tax drops to 8 percent effective July 2017.	State and local sales taxes; business license fees; local marijuana taxes.
Washington	37 percent excise tax on marijuana sales price. Previously a 25 percent tax on producer sales to processors, another 25 percent tax on processor sales to retailers, and a further 25 percent tax on retailer sales to customers.	State Business & Occupation (B&O) taxes; state and local sales taxes.
Oregon	25 percent excise tax on marijuana sales price. Drops to 17 percent tax when regulatory structure begins operation in late 2016.	Localities can add another 2 percent tax.
Alaska (not yet in effect)	\$50 per ounce on marijuana cultivator, or approximately 20 percent effective tax rate. May change before implementation in late 2016.	
District of Columbia	Federal law currently prohibits DC from taxing marijuana.	

California

Many cities in California have adopted taxes on marijuana businesses. For instance, Berkeley adopted a ten percent (10%) tax on recreational marijuana in anticipation of legalization. Richmond (5%) also adopted gross receipts taxes which cover all marijuana businesses.

If the City wishes to address the gross receipts taxes for MRBs covered under MMRSA and AUMA, the City could draft a ballot measure that would:

- expand the existing tax to cover all MRBs;
- propose a new tax on MRBs not covered under Prop D;
- propose a series of new taxes for different types of MRBs; or,
- propose an increase to the existing tax and expands the tax to cover all MRBs.

ACTION

A1. Should all MRBs be taxed at the same rate?

-Yes: Instruct the CAO with the assistance of the Office of Finance to report back with a recommended rate.

-No: Instruct the CAO with the assistance of the Office of Finance to report back with a list of rates that could be applied to different segments.

ACTION

A2. What types of inspection and/or permit fee(s) should be charged to marijuana businesses?

A. Fixed cost (based on square footage) per type of inspection/permit?

-Yes: Instruct staff to report back on options to implement the measures outlined above.

-No: Instruct staff to report back on alternatives for other City Departments to conduct inspections.

B. Fixed cost per type of inspection/permit + Labor (\$/hour)?

-Yes: Instruct staff to report back on options to implement the measures outlined above.

-No: Instruct staff to report back on alternatives.

Penalties

Once the City has resolved the above issues, the City should review its existing penalty and fine structure to ensure that the necessary tools are available for enforcement agencies to compel compliance. Other jurisdictions have established fines and penalties between \$10,000 and \$20,000 for marijuana related violations.

ACTION

A3. What types of penalty fee(s) should be charged to MRBs?

A. Fixed cost per type of penalty?

-Yes: Instruct staff to report back on options to implement the measures outlined above.

-No: Instruct staff to report back on alternatives for other City Departments to conduct inspections.

B. Progressive Penalty (Increase in penalty fee based on number of times MRB has been fined for penalties)?

-Yes: Instruct staff to report back on options to implement the measures outlined above.

-No: Instruct staff to report back on alternatives.

MAS:JLK:02070054c

Report Back No.4

Attachment

List of Other California Cities with Marijuana Taxes

Berkeley

- 2.5% tax on gross sales receipts for medical marijuana
- 10% tax on recreational marijuana (in anticipation of legalization)

Oakland

- 5% tax on gross sales receipts
- Currently covers dispensaries

Cathedral City

- 10% tax on gross sales receipts
- It was 15%, but the City Council has adopted a resolution lowering it to 10%
- Covers all cannabis businesses, not merely dispensaries, including any activity or business that involves planting, cultivating, harvesting, transporting, dispensing, delivering, providing, manufacturing, compounding, converting, processing, preparing, storing, packaging, or testing marijuana.

Palm Springs

- 10% tax on gross sales receipts
- Can be increased to a maximum of 15%

Richmond

- Business License Tax of 5% of gross sales receipts
- Covers all cannabis businesses, not merely dispensaries, including but not limited to commercial cannabis gardens and edibles kitchens.

Sacramento

- 4% tax on gross sales receipts
- Enacted by voters
- Covers all medical cannabis businesses

San Jose

- 10% tax on gross sales receipts
- Enacted by local ballot

Vallejo

- 10% tax on gross sales receipts
- Tax itself enacted by voters
- Council set the tax rate