



ERIC GARCETTI
MAYOR

July 27, 2018

Honorable Members of the Budget and Finance Committee
City Clerk
City Hall, Room 395

REQUIRING NON-CASH TRANSACTIONS AND TAX PAYMENTS FOR THE CANNABIS INDUSTRY (C.F. 17-0768)

Dear Honorable Members:

The Office of Finance (Finance) was instructed (C.F. 17-0768) to report back on the viability, benefits and possible detriments of requiring cannabis businesses operating in the City to conduct only non-cash transactions and to pay taxes and fees by cashless means.

The cash intensive nature of the cannabis industry has been well documented, as have the risks associated with this cash. On November 7, 2017, the California State Treasurer (State Treasurer) issued a report outlining issues and recommendations for confronting the cash intensive nature of the cannabis industry based on a year's worth of study and meetings conducted by a cross-representational working group of government, law enforcement, cannabis industry, and financial services experts.

Among the issues highlighted in the State Treasurer's report is that adult-use cannabis in California is anticipated to exceed \$7 billion in annual sales and \$1 billion in taxes. State Treasurer John Chiang observes, "It is unfair and a public safety risk to require a legal industry to haul duffle bags of cash to pay taxes, employees, and utility bills. The reliance on cash paints a target on the back of cannabis operators and makes them and the general public vulnerable to violence and organized crime."

In addition to the risk to public safety, cash industries also pose various operational problems for the City, including:

AN EQUAL OPPORTUNITY-AFFIRMATIVE ACTION EMPLOYER

1. Audit challenges
2. Crime risk
3. Increased cost

Recognizing the significant issues associated with cash in the cannabis industry the City Council requested (C.F. 17-0768) the City Attorney to draft an ordinance requiring cannabis businesses to conduct only non-cash transactions and tax payments.

In response, the City Attorney submitted a draft ordinance to City Council on November 30, 2017 which, if adopted, would prohibit cannabis businesses from accepting cash from customers or from making cash payments to the City. While the capability of all licensed cannabis businesses to pay by non-cash means is presently unknown to Finance, recent experience shows that about half of the business tax monies received from Medical Marijuana Dispensaries are in cash. The City Attorney may further opine as to any legal implications of cashless requirements. Should the City require cashless operations (or cashless tax payments) by all cannabis businesses then Finance’s risks and need for cash acceptance solutions would be significantly alleviated as Finance has multiple other current options for accepting payment. Otherwise, Finance is poised to spend millions of dollars providing cash acceptance facilities and services over the next several years.

Anticipated Facility and Direct Costs for Cannabis Cash Acceptance by Finance

FY 2017-18	FY 2018-19	FY 2019-20
\$500+ Thousand	\$1+ Million	\$2+ Million

These new expenses are required for facilities, staffing, security, equipment and supplies in support of accepting cash from the cannabis industry.

Increasing Challenge

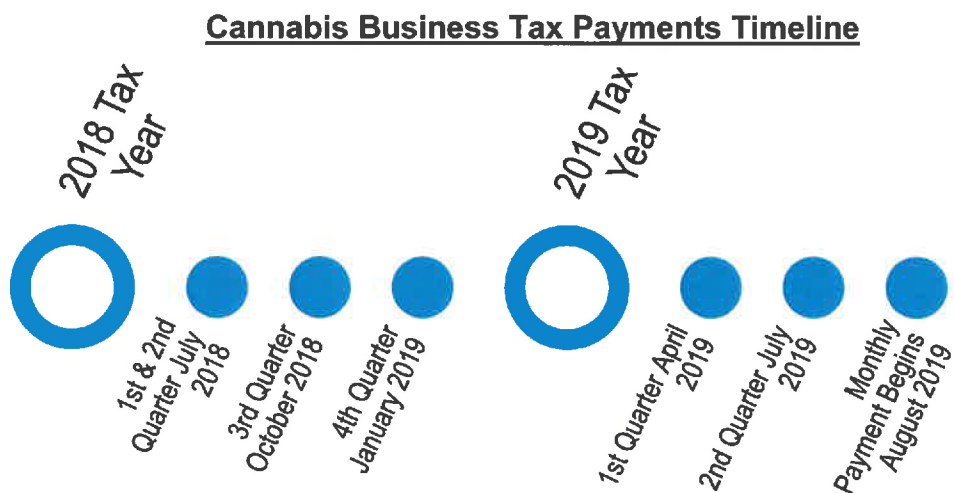
Finance has previously reported on cash acceptance challenges and needs in reports to Council dated March 6, 2017, “Office of Finance’s Plan on Tax Collection of Cannabis Business Activity” and dated September 18, 2017, “Office of Finance – Secure Cash Operations.” This report continues to build on these prior reports in furthering Finance’s evolving plans for collection of tax and fee payments from the cannabis industry and further reporting on resource requirements.

In previous years, Finance collected cannabis tax payments from an established number of businesses on an annual basis; however, Finance’s contacts with the cannabis industry are increasing in two significant respects:

1. Los Angeles Municipal Code (LAMC) Section 21.51 Taxation of Cannabis

All business taxes shall be due and payable quarterly ... beginning July 1, 2018, which shall include any taxes owed from January 1, 2018, and then monthly ... beginning July 1, 2019.
– LAMC Section 21.51

Beginning in Fiscal Year (FY) 2018-19 the number of licensed cannabis businesses, number of annual cannabis taxpayer contacts, and total dollar value of cannabis business tax payments are all expected to increase as the City is issuing more licenses and is requiring quarterly (FY 2018-19) and then monthly (FY 2019-20) Business Tax payments from the cannabis industry.



2. License Fee Collection

Finance has worked closely with the Department of Cannabis Regulation (DCR) the past several months. Finance established the payment mechanisms, license production, public counter and customer support necessary for the initial roll out of cannabis licensing in January 2018, in part relying on resources provided by the Mayor and Council in November 2017 (C.F. 16-0600-S170). Finance’s ongoing role in license fee collection may benefit from some economy of scale if continued under Finance, but now must also be considered in Finance’s future operating requirements.

Cannabis Cash Acceptance Strategies

Finance currently receives online tax payments through credit card, debit card, e-check or Automated Clearing House transfers. Taxpayer payments can also be received by third-party payment processors such as bank lockbox, collection agencies, or cannabis industry financial service organizations. Finance is prepared to accept non-cash payments from cannabis businesses, but Finance continues to prepare for cash payments from cannabis businesses going forward as in accordance with LAMC Section 21.51(e) wherein:

...Finance shall ... implement ... set times and secure conditions whereby every person subject to business tax ... is allowed to pay, in cash.

Finance is taking a multi-tiered approach to addressing the operational challenges posed by large volume cash acceptance. Following is a discussion of the short, mid and long-term strategies Finance is employing along with estimates of associated costs where available.

1. Short-Term Solutions – FY 2017-18

The approaches undertaken by Finance to cope with the large influx of cash that has occurred over the past two years are extensively detailed in Finance's aforementioned report dated September 18, 2017. Primarily this approach focused on improving procedures, equipment, facilities and security, as well as enhancing staffing. Funding provided by Mayor and Council in November 2017 in response to Finance's aforementioned reports provides the short-term augmentations realistically realizable in the fiscal year.

2. Mid-Term Solutions – FY 2018-19

In FY 2018-19, beginning July 2018, LAMC Section 21.51(d) requires cannabis businesses to make quarterly payments to Finance. It is unknown to Finance how many cannabis businesses will be licensed in the current fiscal year, but presently there are 156 licensed businesses with the possibility of hundreds more licensed businesses this year. Based on this, Finance has established an improved large cash acceptance station in City Hall for FY 2018-19. This is important as while Finance is working with the City Administrative Officer (CAO) to identify additional space for increasing the number of cash acceptance stations, additional space has yet to be designated. The funding provided in the 2018-19 Adopted Budget for cannabis cash acceptance is \$947,507 for staffing, security services, equipment, and office supplies. Several key enhancements have been made in FY 2018-19 as a newly upgraded and secured cash acceptance station is operational.

3. Long-Term Solutions – FY 2019-20 and Beyond

In FY 2019-20, beginning August 2019, LAMC Section 21.51(d) requires cannabis businesses to make monthly payments to Finance. It is likely by this point that a greater

number and more efficient arrangement of large cash acceptance stations along with increased staffing will be necessary to accommodate the increase in payment frequency. There are many unknown variables to factor, but an increase in dedicated cash acceptance space and resources, along with continuously improving security will likely be necessary. As such, Finance is pursuing two primary options for future cash acceptance needs as discussed below.

A. Facilities

Finance has been working with CAO to identify future cash acceptance space options. Presently, the option being explored is the possibility of freeing space in City Hall for conversion into large cash acceptance facilities. It is presently unknown what costs would be for build-out of cash acceptance facilities or what level of demand for cash payments the City requires two years from now; however, Finance is using the State of Oregon as a proxy.

The State of Oregon has consolidated cash collection for the cannabis industry at a single location. At the time of Finance's last discussion with the State of Oregon there were about 370 licensed cannabis businesses in Oregon with about 180 businesses making monthly cash payments at five cash acceptance stations. Based on the information received from State of Oregon representatives, the facility upgrade for cash acceptance cost approximately \$1 million. Additionally, the State of Oregon increased staffing by ten positions dedicated to cash acceptance responsibilities, as well as assigning two State Police Officers to cash acceptance security.

Absent other solutions, it is imperative that an adequate cash acceptance location be identified and facility established in order to meet the anticipated future demand from the cannabis industry.

B. Enhanced Armored Courier Services

The aforementioned State Treasurer's report dated November 7, 2017 seeks to pursue a new business model with armored courier services wherein armored couriers would receive cash payments directly from taxpayers, and then count, process and credit to the taxing agency's account. Finance is monitoring developments as this model could significantly reduce the City's operational challenges and risks associated with cash acceptance and may obviate the need for cash acceptance facilities.

Risk Reduction and Cost Recovery

Regardless of the solutions employed, the City is taking on greater risks and costs than normal for receiving payments from the cannabis industry. The City should consider cost recovery for

Finance's costs associated with large cash collection and licensing of the cannabis industry. Finance can work with the CAO and City Attorney to determine an assessable fee.

Recommendations

It is recommended that the City Council:

1. Instruct the Office of Finance, with the assistance of the Department of General Services, Bureau of Engineering, Information Technology Agency, Los Angeles Police Department, Office of the City Administrative Officer, and any other necessary departments to continue to identify and develop options to address space issues, cash acceptance facility requirements, and security needs related to cannabis cash acceptance.
2. Instruct the Department of Cannabis Regulation, with the assistance of the Office of Finance and Office of the City Administrative Officer, to examine Finance's costs associated with Cannabis licensing activity and to determine and recommend an appropriate amount to include in cannabis licensing fees.
3. Instruct the Office of the City Administrative Officer, with the assistance of the City Attorney and Office of Finance, to prepare a large cash acceptance fee analysis and recommend an appropriate fee for cost recovery of related City expenditures.

If there are any questions, please contact Wai Yee Lau, Assistant Director of Finance, at (213) 978-1776 or by e-mail at wai.y.lau@lacity.org

Sincerely,



Claire Bartels
Director of Finance / City Treasurer

cc: Miguel Sangalang, Deputy Mayor, Budget and Innovation, Mayor's Office