



# Agenda Report

February 26, 2018

**TO:** Honorable Mayor and City Council

**THROUGH:** Finance Committee

**FROM:** Department of Finance

**SUBJECT: CONSIDERATION OF AN ORDINANCE AMENDING TITLE 5 OF THE PASADENA MUNICIPAL CODE TO ADD A NEW CHAPTER 5.28 ENTITLED "CANNABIS BUSINESS TAX"**

## **RECOMMENDATION:**

It is recommended that the City Council:

1. Find that the proposed action is not a project subject to California Environmental Quality Act (CEQA) as defined in Section 21065 of CEQA and section 15378 of the State CEQA Guidelines and, as such, no environmental document pursuant to CEQA is required for the project; and
2. Approve the submission of the Ordinance imposing a cannabis business tax to the qualified voters of the City of Pasadena; and
3. Adopt a Resolution declaring a fiscal emergency for purposes of placing the proposed ordinance on the ballot of the June 5, 2018 election.

## **BACKGROUND:**

Historically, Pasadena has disallowed commercial cannabis activity within the City. Commercial cannabis uses are specifically prohibited in the City's Health and Safety Code and in the Zoning Code. Without repealing existing bans, on November 13, 2017, the City Council approved the second reading of three ordinances relating to cannabis use and commercial cannabis activity within the City. These latest ordinances combined to clarify and strengthen the City's existing prohibitions on commercial cannabis activity in response to the State of California's legalization of recreational/nonmedical cannabis, and the Legislature's accompanying laws establishing a regulatory framework.

As discussed with the City Council on January 22, 2018, proponents in favor of allowing commercial cannabis activity have focused on pursuing their interests through the referendum and initiative process. At the January meeting, the City Council discussed the potential of putting a ballot measure on the June 2018 ballot to ask the voters to approve both regulations and a tax measure to legally permit commercial cannabis uses in the City, or, in the alternative, proceeding to enact regulations pursuant to the City's usual legislative process. The City Council directed staff to bring back the proposed regulations and tax information for consideration.

### **TAXATION OPTIONS**

Regardless of the action that may be taken regarding land use regulations pertaining to cannabis, staff recommends seeking voter approval for a cannabis business tax to be applied to cannabis sales. This tax would be a separate ballot measure not linked to either the proponents' initiative should it qualify for the ballot or any City proposed regulations. The proposed tax would be a general tax and, to be approved, would require a simple majority vote (50% +1). As evidenced in recent years, cannabis dispensaries often create negative impacts for surrounding neighborhoods. The imposition of a cannabis business tax would help to fund general municipal services such as police and code enforcement services necessary for the proper administration of regulations. Moreover, such revenues could also be used to promote health education, particularly to young people, regarding the dangers of smoking cannabis.

Determining appropriate tax rates is important to the entire economic cycle of cannabis cultivation, manufacturing, and sale because a cumulative tax rate that is too high will drive the legal market underground. Based on analysis from the City's consultant and in reviewing what has occurred in Colorado, Washington, and Oregon, staff believes an appropriate tax level is about 30 percent, cumulatively, for the entire supply chain (from seed to sale). In July 2017, in an effort to combat the black market, Colorado reduced its state tax from 10 percent to 8 percent, reducing its overall effective tax rate to about 29 percent. Considering California taxes alone, before any local taxes are imposed, the cumulative tax rate is slightly more than 25 percent, leaving little room for local agencies to reasonably assess additional cannabis taxes.

The taxes proposed and outlined below would set the cumulative tax rate to approximately 30 percent. The cumulative rate varies since the state's cultivation tax is assessed per ounce. Wholesale prices in California in November 2017 were as high as \$2,500 per pound and as low as \$500 per pound. Wholesale prices in Colorado, Washington, and Oregon have all dropped since initial legalization and range from an average of \$1,100 to \$2,600 per pound, with the price variance primarily dependent on quality. Tables of the cumulative tax rate based on wholesale prices of \$1,000 and \$2,000 per pound are provided as Attachment A.

The intent of staff's proposed cannabis tax is to levy a tax on all cannabis businesses that operate in the City, regardless of whether such business were legal at the time the

ordinance was adopted. Nothing in the ordinance is intended to authorize or permit otherwise illegal business activity.

If approved by the voters, the proposed cannabis tax would be imposed on each person who is engaged in cannabis business regardless if the business has been issued a permit to operate lawfully in the City. Tax rates covering a variety of potential cannabis businesses are included in the proposed ballot measure and would remain in place even if voters, or the Council through the usual legislative process, elect not to permit certain types of business altogether. Initial rates are proposed along with maximum rates that can be set by the City Council through a resolution or ordinance.

Staff proposes the initial rates to be as follows:

1. For every person who is engaged in commercial cannabis cultivation in the City:
  - a. Seven dollars (\$7) annually per square foot of canopy space in a facility that exclusively uses artificial lighting;
  - b. Four dollars (\$4) annually per square foot of canopy space in a facility that uses a combination of natural and supplemental artificial lighting;
  - c. Two dollars (\$2) annually per square foot of canopy space in a facility that uses no artificial lighting;
  - d. One dollar (\$1) annually per square foot of canopy space for all nurseries.
2. For every person who engages in the operation of a testing laboratory: one percent (1%) of gross receipts.
3. For every person who engages in the retail sales of cannabis as a retailer (dispensary) or non-store front retailer (delivery) or microbusiness (retail sales): Four percent (4%) of gross receipts.
4. For every person who engages in a cannabis distribution business: two percent (2%) of gross receipts.
5. For every person who engages in a cannabis manufacturing, processing, or microbusiness (non-retail), or any other type of cannabis business not described in Section (1), (2), (3) or (4): Two and half percent (2.5%) of gross receipts.

Staff proposes the maximum rates to be as follows:

1. For every person who is engaged in commercial cannabis cultivation in the City:
  - a. Through June 30, 2021, the maximum rate shall be:
    - i. Ten dollars (\$10.00) annually per square foot of canopy space in a facility that exclusively uses artificial lighting;

- ii. Seven dollars (\$7.00) annually per square foot of canopy space in a facility that uses a combination of natural and supplemental artificial lighting;
  - iii. Four dollars (\$4.00) annually per square foot of canopy space in a facility that uses no artificial lighting;
  - iv. Two dollars (\$2.00) annually per square foot of canopy space for all nurseries.
- b. From July 1, 2021 going forward, the maximum annual tax rate would increase by the annual percentage change in the Consumer Price Index.
2. Testing laboratories -- two and a half percent (2.5%) of gross receipts.
  3. Retail sales -- six percent (6%) of gross receipts.
  4. Cannabis distribution -- three percent (3%) of gross receipts.
  5. Cannabis manufacturing, processing, or microbusiness (non-retail activity) or any other type of cannabis business -- four percent (4%) of gross receipts.

Collection of the cannabis business tax would be done through the City's existing business tax process. Business tax is generally submitted annually; however, staff proposes the cannabis business tax be payable quarterly. Upon cessation of a business, any tax due would become due immediately. Failure of timely payment, would result in a penalty of 10 percent plus interest for the first month and will increase to 25 percent plus interest for each exceeding month beyond the due date.

#### **DECLARATION OF A FISCAL EMERGENCY**

Proposition 218 requires new and increased taxes and extensions of taxes to be voted on only at a regular general election of the City at which members of the City Council are elected, unless the City Council adopts a finding of emergency by a unanimous vote of the Councilmembers present. Only in that case, the tax can be voted on at a special election.

The declaration of a fiscal emergency will allow the City to bring the proposed cannabis tax measure to the voters at a June 5, 2018 special election. Without such a unanimous declaration of a fiscal emergency, the City must wait until the next regular general election to submit a tax measure requiring approval of a simple majority vote (50% +1).

In November 1996, California voters passed the Compassionate Use Act, legalizing the medical use of cannabis. In November 2016, California voters passed Proposition 64 to legalize adult recreational use of cannabis and to allow businesses that support such cannabis use to operate legally, subject to regulations imposed by state and local public entities. In July 2017, Governor Brown signed into law the Medicinal and Adult Use Cannabis Regulation and Safety Act (MAUCRSA), which establishes a licensing regime

for both medical and adult use cannabis. The permitting and support of the cannabis industry has significant cost implications for the City of Pasadena due to the substantial costs to the City of adopting and implementing regulations to govern this new industry, enforcing those regulations and ensuring public safety, educating residents and businesses, addressing environmental concerns, providing educational services, and providing other related services. The City must identify a funding source to support regulation of cannabis businesses while not adversely impacting the general fund in order to maintain consistent funding and financial stability for essential services such as fast and effective 911 services, police and fire protection, road repairs, quality neighborhood parks and recreation areas, and other vital community services.

The City's existing general business tax ordinance, which generally levies limited business tax on all businesses operating in Pasadena, is insufficient to generate the volume of revenue needed to pay for the City's costs of regulating the cannabis industry. Therefore, staff requests the City Council unanimously declare the existence of a fiscal emergency within the City as part of submitting the cannabis business tax to the voters.

While staff has requested the Council declare a fiscal emergency as described in the attached resolution, there is a proposed statewide ballot measure that could inform the requirements for the measure, even retroactively. The proposed statewide measure, currently in the signature-gathering phase, would amend the California Constitution to change the rules for how local governments can impose taxes, fees, and other charges, and is currently proposed for the November 2018 ballot. The most significant provision of the statewide measure, as relevant here, is that it would require proposed local tax increases to be subject to a two-thirds vote. It eliminates local authority to impose a tax for general purposes by majority vote. The measure would also apply retroactively and invalidate taxes imposed since January 1, 2018, unless taxes meet criteria of the statewide measure. Staff is continuing to monitor the progress of the statewide measure, as it moves through the signature-gathering process.

#### **SUMMARY:**

Prior to the adoption of regulations to legalize commercial cannabis in Pasadena, a taxation system should be in place to ensure the City can generate funding for the necessary enforcement and education components. The proposed tax structure provides a responsible taxation system to generate new revenue for the City, while not taxing too high to encourage a black market on sales. Additionally, the proposed tax structure would be applicable to all cannabis-related businesses, regardless of whether they had obtained permits to operate legally within the City of Pasadena. Existing illegal businesses in Pasadena have already obtained reseller licenses through the State of California for sales tax purposes and are currently remitting the require sales tax payments.

The proposed tax structure is anticipated to generate \$1 million to \$2 million in annual revenue based on the previous discussions of limiting the number of permits. It is

anticipated that this tax revenue will increase over time as prices increase and the tax rate increases to the maximum amounts proposed.

**COUNCIL POLICY CONSIDERATION:**

The proposed action is consistent with the City Council's strategic planning goal to maintain fiscal responsibility and stability.

**ENVIRONMENTAL ANALYSIS:**

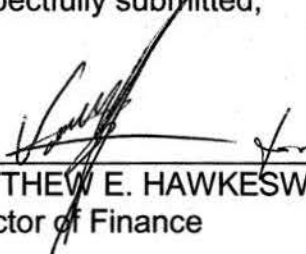
The action proposed herein is not a project subject to the California Environmental Quality Act (CEQA) in accordance with Section 21065 of CEQA and State CEQA Guidelines Section 15060 (c)(2), 15060 (c)(3), and 15378. Since the action is not a project subject to CEQA, no environmental document is required.

**FISCAL IMPACT:**

The proposed tax structure is estimated to generate \$1 million to \$2 million annually for the General Fund. While these funds will and can be used for any general governmental purposes, it is anticipated that the City will likely incur offsetting new costs related to enforcement and educational efforts. If a measure is put before the voters in June 2018 and is approved, the tax would become effective July 1, 2018; however, revenue generated from the tax would not be included in the Fiscal Year 2019 budget.

Since the City is already contemplating placing Charter amendments on the June 2018 ballot, the estimated cost to include a cannabis tax measure on the same ballot is less than \$25,000. If this measure was placed on the ballot without the consolidation, the cost is estimated at more than \$150,000.


Respectfully submitted,



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MATTHEW E. HAWKESWORTH  
Director of Finance

Approved by:



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STEVE MERMELL  
City Manager

Attachments: (3)

1. Attachment A – Cumulative Cannabis Tax Projections
2. Attachment B – Proposed Cannabis Tax Ordinance
3. Attachment C – Resolution Declaring a Fiscal Emergency