



# CITY OF SANTA BARBARA

## COUNCIL AGENDA REPORT

**AGENDA DATE:** June 28, 2016

**TO:** Mayor and Councilmembers

**FROM:** Paul Casey, City Administrator  
Ariel Calonne, City Attorney

**SUBJECT:** Marijuana Business Tax Ballot Measure: The Santa Barbara  
Marijuana Control Act

### RECOMMENDATION:

That Council adopt, by reading of title only and unanimous vote, A Resolution of the Council of the City of Santa Barbara Calling and Giving Notice of a Consolidated Special Municipal Election to be Held in the City of Santa Barbara on Tuesday, November 8, 2016 for the Submission of a Ballot Measure to the Voters of the City Pertaining to Enactment of a General Tax on the Gross Receipts of Marijuana Businesses.

The accompanying Resolution:

1. Calls a special municipal election and places the Santa Barbara Marijuana Control Act on the November 8, 2016 ballot;
2. Makes an emergency declaration pursuant to Article 13C of the California Constitution to support placing the measure on the 2016 ballot;
3. Proposes to the voters an ordinance enacting the marijuana business tax at the rate of 10% of gross receipts for medical marijuana and 20% of gross receipts for non-medical marijuana;
4. Authorizes the Mayor to file a written ballot argument on behalf of the City Council;
5. Directs the City Attorney to prepare an impartial analysis;
6. Requests consolidation of the City's special municipal election with the County-run Statewide General Election; and
7. Recognizes and agrees to reimburse the County for any additional costs incurred as a result of consolidating the elections.

## **DISCUSSION:**

### **Background**

On May 24, 2016, the City Council unanimously directed preparation of a ballot measure to impose a marijuana business tax upon existing and future marijuana businesses. Owing to the County's accelerated ballot measure schedule, July 7 is the last day to file a proposed measure with the Clerk of the Board of Supervisors. The Board of Supervisors' last available action date is July 19, 2016. Accordingly, June 28<sup>th</sup> is the last day for Council action on this matter. As we advised in May, the California Constitution requires a unanimous Council emergency declaration before placing a general tax on the ballot in a year when Council Members are not up for election.

The Brown Act limited the Council's ability to provide specific direction on May 24<sup>th</sup>. As a result, the City Administrator and City Attorney have made several policy and legal decisions which are reflected as our recommendations in the proposed ballot measure ordinance and election resolution. These include the following major considerations:

- A taxing system model that is similar to the City's existing business tax ordinance in Chapter 5.04 of the Santa Barbara Municipal Code;
- The tax is imposed on marijuana businesses, not marijuana patients, caregivers or customers;
- A two tier tax structure under which medical marijuana businesses are taxed at a lower rate than non-medical marijuana businesses;
- A tax rate of 10% of gross receipts for medical marijuana businesses and 20% of gross receipts for non-medical marijuana businesses;
- A broad definition of "marijuana business" to encompass both lawful collective and cooperative medical dispensaries, as well as currently illegal non-medical businesses which would become lawful under state law should the Adult Use of Marijuana Act be approved by the voters in November 2016. The definition also encompasses transportation, delivery and other marijuana-related services;
- Entitling the measure the "Santa Barbara Marijuana Control Act" because the tax proceeds will be used for general city services needed to control marijuana businesses effectively, including crime prevention, police services, zoning enforcement and regular monitoring;
- Extensive emergency findings that explain the City's financial situation along with the burdens placed on the City by virtue of marijuana businesses;

- Authorization for the Mayor to prepare the City's ballot argument, as Council provided in the 2008 Utility User Tax modernization ballot measure; and
- Acceptance of the Howard Jarvis Taxpayers Association-sponsored AB 809, which was effective January 1, 2016, and which requires the ballot label presented to the voters on tax measures to include the amount of money to be raised annually, the tax rate and the tax duration.

## **Analysis**

### **History of City Regulation**

The City's medical marijuana storefront dispensary ordinance allows up to three permitted storefront dispensaries within the City. No more than one dispensary may exist within any of five areas in which dispensaries may be permitted. As of today, there are two City permitted dispensaries, but neither has begun operating. They will be located at 3617 State Street and 118 N. Milpas Street. A third dispensary is in the review process and would be located on De La Vina Street.

The City has the legal authority to impose a business or excise tax upon the gross receipts of marijuana sales, services and transactions, provided the tax is approved by the voters as required by the California Constitution. If the proceeds of such a tax are dedicated to general governmental purposes, a simple majority may pass the tax. However, general taxes may be proposed only on a regularly scheduled City Council election ballot, "except in cases of emergency declared by a unanimous vote of the governing body." (Cal. Const., art. 13C, §2.)

When the storefront dispensary ordinance was adopted in 2010, the City Council did not seek voter approval to create a separate business tax classification specifically for marijuana businesses. At that time, state law and the City's ordinance required medical dispensaries to operate under a collective or cooperative model. The 2015 state law amendments that created the Bureau of Medical Marijuana Regulation recognize a more traditional purchase-sale system for medical marijuana. In any event, under former and current state law, the State Board of Equalization has ruled that medical marijuana transactions are subject to state sales tax, regardless whether money changes hands. Unlike physician-prescribed or -provided medications, medical marijuana is not exempt from sales tax because there is no prescription, just physician "recommendations." Accordingly, medical marijuana transactions in Santa Barbara are now subject to payment of the state transactions and use (sales) tax.

### **The Proposed Ballot Measure**

The proposed ballot measure would create a new business tax with categories that distinguish between "medical" and "non-medical" marijuana businesses. The proposed

measure would establish a business tax rate for medical marijuana businesses of 10% of gross receipts. Non-medical marijuana businesses would pay a business tax rate of 20% of gross receipts.

The proposed tax would be a general tax, requiring a simple majority approval of voters. As such, the monies would be deposited into the City's General Fund and would be used to pay for general services, such as police, fire, recreation, parks, and library services.

The medical marijuana business tax would apply to City permitted dispensaries and any mobile dispensaries. Currently, mobile dispensaries are not allowed within the City; however, the tax would apply to mobile dispensaries located outside the City but doing business within the City limits even if operating unlawfully relative to the City's ordinances.

While not currently permitted in the City of Santa Barbara, the proposed new non-medical marijuana business tax would apply to other commercial activities related to the distribution of the medical marijuana, including planting, cultivating, harvesting, transporting, delivery, manufacturing, compounding, converting, processing, preparing, storing, packaging, wholesale, and retail sales of marijuana and its derivatives.

## **FISCAL IMPACT:**

### **Fiscal Impacts of Non-Medical Marijuana Legalization**

As we have previously reported, the statewide initiative entitled the Adult Use of Marijuana Act (AUMA) has been submitted to the Secretary of State with ample signatures for approval. If approved by the voters in November, the AUMA will impose a 15% state excise tax on medical and non-medical marijuana. The AUMA will also impose a cultivation tax on marijuana flowers and leaves. The AUMA will, however, exempt medical marijuana from the existing state transactions and use (sales) tax. Finally, the AUMA allows cities to use existing their authority to impose taxes on medical or non-medical marijuana.

The AUMA will substantially increase the City's regulatory and enforcement burdens by creating a new governance structure for state and local marijuana businesses. We anticipate that substantial expenditures will be needed to support the state system, for local enforcement, for development of local regulations, and to develop systems to assure public health and safety around a broad spectrum of marijuana businesses

### **Analysis of Local Revenue Impacts from Medical Marijuana**

The proposed medical marijuana business tax of 10% would be applied to gross receipts. However, projecting how much the tax would generate in new revenue is difficult. The following summary provides some information from several cities that have

implemented a tax on medical marijuana. In virtually all cases, the information is based on revenues generated from dispensaries; very little, if any, of the revenues described below stem from other activities, such as delivery, cultivation, or manufacturing edibles and oils.

- Santa Cruz – 7% tax on gross proceeds from dispensaries. There are currently two dispensaries, which are expected to generate a total of \$300,000 in revenues to the City in Fiscal Year 2016. This translates to \$4.3 million in gross receipts, or \$2.15 million per dispensary.
- Palm Springs – 10% tax on proceeds from collectives with a valid City Council-issued permit and a 15% tax on proceeds from collectives that do not have a City Council-issued permit. As of December 2015, six dispensaries have been permitted, with five (5) currently open and no unpermitted dispensaries. In Fiscal Year 2015, the City generated \$1.1 million in tax revenues, which translates to approximately \$10 million in total gross receipts, or \$2 million per dispensary.
- San Jose – 10% tax on gross receipts. There are currently 16 dispensaries in operation. Total tax revenues projected in Fiscal Year 2016 are \$7 million, which translates to \$70 million in total gross receipts, or \$4.4 million in gross receipts per dispensary.
- Sacramento – 4% tax on gross receipts from dispensaries. Media reports indicate that in Fiscal Year 2015 the City collected \$3 million from the 4% tax. Currently, thirty (30) dispensaries are operating in the city, which translates to \$75 million in total gross receipts, or \$2.5 million per dispensary.
- Oakland – 5% tax on gross receipts. There are currently eight (8) active dispensaries in the City, which are generating approximately \$60 million in total gross receipts, or \$7.5 million in gross proceeds per dispensary.

In projecting the revenues that might be generated by the City of Santa Barbara, we believe the cities of Palm Springs and Santa Cruz provide the best indicators of the revenues a Santa Barbara tax might generate. Both Santa Cruz and Palm Springs report gross receipts of approximately \$2 million per dispensary. However, because the approved Milpas dispensary is limited in client volume to 150 patients per day, its gross receipts may not reach the same level as the other two permitted dispensaries. As a result, we have discounted the estimate by 25% for the one dispensary.

Based on the data presented above, the estimated total annual gross receipts for the three permitted dispensaries, when fully operational, would be in the range of \$5.5 million [(\$2 million x 2 dispensaries) + (\$2 million x 75% x 1 dispensary)]. Therefore, the medical marijuana business tax would generate estimated revenues of \$550,000 annually based on the proposed 10% tax rate.

### Analysis of Local Revenue Impacts from Non-Medical Marijuana

There is very little data upon which to extrapolate the level of sales that would occur if non-medical marijuana is legalized, and thereby estimate potential tax revenues. Accordingly, we have prepared a very conservative estimate.

Our estimate is based upon the following assumptions:

1. The number of permitted dispensaries in the first several years would remain at three (3).
2. The existing dispensaries would expand their business to include the sale of marijuana for both medical and non-medical purposes.
3. The gross receipts would double from the medical estimates discussed above, with the incremental growth coming solely from the sale of marijuana for non-medical purposes.

Using these assumptions, the gross receipts would double, increasing \$5.5 million to \$11 million. The incremental gross receipts would be taxed at the 20% rate (versus the 10% rate for marijuana sold for medical purposes). Therefore, the *incremental* tax revenues generated from the sale of non-medical marijuana is estimated at \$1.1 million (\$5.5 million x 20%). This would bring the total estimated tax revenues to the City, assuming non-medical marijuana sales were legalized) to \$1.65 million annually.

Should the City restrict non-medical sales, or if new non-medical dispensaries open in Santa Barbara, our estimates could change dramatically.

The table below summarizes the estimated tax revenues for both medical and non-medical marijuana.

<b>Tax Rate</b>	<b>Estimated Gross Receipts</b>	<b>Estimated Tax Revenues</b>
Medical Marijuana Tax – 10%	\$5,500,000	\$ 550,000
Non-Medical Marijuana Tax – 20%	\$5,500,000	\$1,100,000
Totals	\$10,000,000	\$1,650,000

The table below presents the varying revenue estimates based on different tax rates for both the medical and non-medical marijuana taxes.

<u>Tax Rate</u>	<u>Estimated Tax Revenues (Medical Tax)</u>	<u>Estimated Tax Revenues (Non-Med Tax)</u>
5%	\$ 275,000	\$ 275,000
10%	550,000*	550,000
15%	825,000	825,000
20%	1,100,000	1,100,000*

\*Proposed

The estimated revenue would be deposited into the General Fund. The City may use the revenue from the tax for any legal municipal purpose, including but not limited to maintenance of vital services and facilities.

### **Other Revenue Considerations**

While the sale of medical marijuana is not legal under federal law, Congress has defunded Department of Justice enforcement activities against medical marijuana in those states where medical marijuana is lawful, including California.

However, banks have generally not allowed marijuana businesses to establish bank accounts based on current federal law. Consequently, cities that have imposed a tax on medical marijuana have had to establish protocols and security procedures for the delivery of cash to their cashiers' office. A cash counting machine is used in most cases to facilitate and expedite the counting of the cash. Some cities have required appointments monthly for dispensaries to bring in the tax monies. In addition, assistance from the police department has been required in some cases to provide added security during the counts. Overall, the cash handling requirements have not created undue challenges or roadblocks to the imposition or collection of the taxes, but they have resulted in additional city costs.

A secondary consideration is the uncertainty of what impacts, if any, the legalization of the non-medical use and sale of marijuana in California would have on revenues generated by the City from its proposed tax structure, which includes taxing non-medical marijuana. The Adult Use of Marijuana Act, an initiative that would legalize recreational use of marijuana, will likely be before California voters this November. The measure would allow adults ages 21 and older to possess, transport and use up to an ounce of marijuana for recreational purposes and would allow individuals to grow as many as six plants. It would also allow for the sale of marijuana for non-medical purposes subject to state licensing and local ordinances. Under the initiative, existing and legal medical marijuana dispensaries would be given priority in securing a state license for the purposes of selling non-medical marijuana. What is not clear is whether existing dispensaries in the City would seek such licensing, and what the City may do to

restrict or prohibit this type of business within the City. To the extent existing dispensaries expand to include the sale of non-medical marijuana and the City does not restrict the sale by new businesses, the gross proceeds would be subject to the non-medical marijuana business tax. This would result in increased revenues beyond those previously discussed above.

**PREPARED BY:** Robert Samario, Finance Director  
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**SUBMITTED BY:** Ariel Pierre Calonne, City Attorney

**APPROVED BY:** City Administrator's Office