CITY OF
LONG BEACH

Memorandum

Date: November 29, 2023

To: Mayor and Members of the City Council

From: Thomas B. Modica, City Manager

Subject: **Proposed Cannabis Tax Relief Plan**

On August 8, 2023, the Budget Oversight Committee (BOC) received an update on the proposed cannabis tax relief plan, which includes a business license tax change and pilot tax credit program as part of the Fiscal Year (FY) 24 budget. This plan evolved out of a series of City Council motions and recommendations dating back to the FY 23 budget process.

The most recent recommendation approved by City Council on April 18, 2023 stipulated the following:

> *Request the City Manager to work with the Office of Cannabis Oversight to develop a tax relief plan to help stimulate the growth of local cannabis retail establishments with structured incentives that promote community benefits, local hiring, livable wages, and fair labor standards, and return to the City Council as part of the FY 24 budget process.*

The initial concept for this proposed cannabis tax relief plan was included as part of the Proposed FY 24 Budget which was approved on September 5, 2023. The intent of this memorandum is to provide City Council with a comprehensive overview of the proposed cannabis tax relief plan for adult-use retail and cultivation businesses, including fiscal impacts to the General Fund and Measure MA revenues.

Research

Staff researched best practices with a focus on community benefits, local hiring, livable wages, and fair labor standards. The most recent and relevant examples found were the City of Santa Ana's recent tax changes and the City of Oakland's tax rebate program. On October 4, 2022, the City of Santa Ana adopted several cannabis regulatory and tax updates including a five percent gross receipts tax reduction (six percent to one percent) for cultivation, manufacturing, and distribution businesses, and a one percent gross receipts tax reduction (eight percent to seven percent) for adult-use retail businesses. This approach closely mirrors the five percent tax reduction (six percent to one percent) for manufacturing, distribution, and lab testing businesses approved by the Long Beach City Council on January 7, 2020.

In addition to the tax reductions approved by the City of Santa Ana, a cannabis retail business seeking certification as a "Qualified Social Equity Commercial Cannabis Business Operator" may be eligible for a two percent tax reduction (seven percent to five percent) if they satisfy and commit to seven social equity measures: full-time jobs, wages, delivery drivers, high road training partnerships, social equity policy, local hiring, and equity opportunities. A business who satisfies all seven social equity measures is certified as a Qualified Social Equity Commercial Cannabis Business Operator by the City of Santa Ana Planning and Building Agency. The reduced tax rate becomes effective on the first day of the first calendar month following confirmation of certification.

Under the full-time jobs and wages measure, a business must have a workforce consisting of 60 percent full-time employees and receive wages that exceed 115 percent above the state minimum wage. This wage requirement does not include supervisors. The delivery drivers measure stipulates that a storefront or non-storefront retailer must reimburse delivery drivers for mileage according to the Internal Revenue Service's standard mileage rates. The High Road Training Partnerships (HRTP) measure requires a business to provide proof of participation in a recognized HRTP initiative sponsored by the California Workforce Development Board.

The social equity policy measure requires a business to describe how they will recruit, hire, and retain employees who reside in low-income census tracts in Santa Ana where at least 51 percent of the current residents have a household income at or below 80 percent of the County Area Median Income; how they will partner with Community Benefit Organizations or its High Road Training Program to recruit, hire, and retain employees arrested or convicted for a crime relating to the sale, possession, use or cultivation of cannabis prior to November 8, 2016 that could have been prosecuted as a misdemeanor or citation under Current California law, or currently receiving unemployment benefits; and any other measures or employee benefits aimed to address the disproportionate impact of the War on Drugs in certain communities affected by it. The local hiring measure requires a business to demonstrate that 20 percent of its employees reside within the City of Santa Ana with this percentage increasing to 40 percent beginning on January 1, 2024.

The equity opportunities measure requires a business to demonstrate that 40 percent of all employees employed in the last tax period were equity employees, or demonstrate that hourly, non-supervisorial employees receive employee stock ownership options or other equity, on or before January 1, 2024. These requirements are similar to those outlined in Sections 5.92.1610 and 5.92.1660 of the Long Beach Municipal Code (LBMC) requiring businesses to employ equity employees for a minimum of 40 percent of total annual work hours performed at the business. The equity employee requirements are administered through the Long Beach Cannabis Equity Employment Program, which was established in 2018 as part of the City's larger cannabis equity initiative, including the equity applicant and business program.

Santa Ana's tax relief approach is different than the City of Oakland's Cannabis Tax Rebate Program, which is based on a rebate of taxes paid for the previous tax year. Under Oakland's program, a business must meet nine separate and distinct conditions within four rebate categories to qualify for a tax rebate. These categories include local hiring, equity supply chain, workforce quality of life, and incubation.

The local hiring rebate category is comprised of three conditions with an eligible rebate amount of 0.5 percent. These conditions require a business to have a workforce consisting of 30 percent "equity employees"—25 percent of whom must be in "essential roles" and 20 percent in “managerial roles”. Equity employees must meet specific eligibility criteria such as living within an eligible police beat or in Oakland with a previous arrest or conviction for a cannabis crime. Essential roles are defined as employment roles within the usual course of the hiring business, while managerial roles involve supervision of other employees or regular exercise of business judgment.

The equity supply chain rebate category is comprised of two conditions with the first condition requiring a business to have 30 percent of the value of cannabis products to be delivered by an equity business for a rebate of 0.5 percent. Similarly, the second condition requires a business to have 25 percent of the value of cannabis products originally cultivated or manufactured by an equity business. The workforce quality of life rebate category is comprised of two conditions with the first condition requiring a business to pay their employees $20 per hour with health benefits or $25 per hour without health benefits for a rebate of 0.5 percent. The second condition stipulates that 80 percent of total employees are full-time at the business for a rebate of 0.25 percent. The incubation rebate category consists of two conditions requiring a business to provide free rent to equity businesses (beyond what is already required as part of their equity program) for a rebate ranging between 0.5 percent to 1.5 percent.

In addition to satisfying these rebate categories, a business must meet the qualifying period requirement which can range between 182 to 365 days, depending on the conditions. Other requirements include timely payment of business taxes in full. It is important to note that a business is not eligible to apply for any rebates that would reduce the overall tax rate to less than 2.5 percent for the qualifying tax year. In other words, a business would be subject to pay a minimum tax rate of 2.5 percent, regardless of the number of eligible rebates.

Proposed Tax Relief Plan

Based on these models and best practices, staff is proposing a tax relief plan that is intended to address City Council priorities while strengthening and enforcing existing local and state cannabis regulations. Using a two-tiered approach, businesses may be eligible for a combined 4 percent in tax relief—while maintaining a two percent minimum tax rate—upon meeting a set of good standing requirements and eligibility criteria outlined below.

Tier 1

Under Tier 1, staff is proposing to reduce the adult-use retail tax rate by one percent (eight percent to seven percent) and the cultivation tax rate by an amount equivalent to a one percent tax reduction ($14.96 to $13.09). The one percent tax reduction will be applied to all adult-use retail and cultivation businesses. It is important to note that the tax base for adult-use retail is based on a percentage of gross receipts with the initial rate set at eight percent. This tax rate has not been adjusted since the imposition of the tax by way of Section 3.80.261 of the LBMC (also known as Measure MA). In contrast, the tax base for cultivation (medical and adult-use) is based on the square footage with the tax initially set at $12.00 per square foot. This tax rate is annually adjusted equivalent to the most recent change in the annual average of the Consumer Price Index (CPI) for all urban consumers in the Los Angeles-Riverside-Orange

County areas as published the United Stated Governor Bureau of Labor Statistics. As of October 1, 2023, the cultivation tax rate is set at $14.96 per square foot under cultivation. Prior to the recent CPI increase, the cultivation tax was set at $13.70 per square foot.

Tier 2

Under Tier 2, staff is proposing a pilot tax credit program that would provide a tax credit of three percent for eligible adult-use retail and cultivation businesses who are in good standing and promote community benefits, local hiring, living wages, and fair labor standards. Ultimately, a business must meet all the good standing requirements and eligibility criteria to receive a tax credit of three percent under the proposed pilot tax credit program. Attachment A outlines a summary of the proposed good standing requirements and eligibility criteria, which are also described below.

Good Standing Requirements

The good standing requirements are intended to strengthen and enforce existing regulations such as tax compliance. Currently, it is estimated that 50 percent of cultivation and adult-use retail businesses are not compliant with the tax regulations stipulated in Section 3.80.261 of the LBMC. This includes nonpayment and/or timely payment of cannabis taxes owed to the City on a quarterly and annual basis. This lack of compliance may be attributed to the pause on late fees and tax penalties for all businesses (including cannabis) put in place as part of the COVID-19 emergency business relief. The late fees and tax penalties for cannabis businesses will be reinstituted as part of a larger approach by the Department of Financial Management, Business License Division, to resume standard business operations. In support of this larger approach, a business interested in applying for the Pilot Tax Credit Program may not have any outstanding local taxes and fees. Businesses enrolled in a payment plan are not eligible to apply for this program until all delinquent local taxes are paid in full. A business must also provide a signed attestation stating that they are current on state taxes owed to CDTFA. In other words, for a business to be in “good standing”, all tax payments must be up to date at the time of application submission.

In addition to tax compliance, a business must be compliant with the regulations set in Chapter 5.90 and Chapter 5.92, including general operating requirements and conditions specific to each cannabis license type. Facility permitting and inspections must also be up to date as required by the Fire Department, Health and Human Services Department, and Community Development Department. Furthermore, given the nature of the cannabis dual-licensing system (local and state), a business must have an active provisional or annual state license issued by the Department of Cannabis Control (DCC) in conjunction with the local license. Provisional licensees must demonstrate in good faith their efforts to transition to an annual license, including compliance with the California Environmental Quality Act (CEQA) requirements for cannabis businesses. Ultimately, these good standing requirements are intended to ensure compliance with local and state regulations.

Eligibility Criteria

Learning from the recent and relevant examples, the eligibility criteria are designed to provide flexibility to businesses and promote meaningful employment and business opportunities using a workforce development and equity lens. The local hiring, workforce quality of life, and training criteria are new requirements as part of this proposed pilot tax credit program. The local hiring criterion is intended to create a career pathway for cannabis entrepreneurs by requiring a business to hire and retain a workforce with 50 percent of employees residing within Long Beach. This coupled with the workforce quality of life criterion is intended to support higher paying jobs for Long Beach residents and stimulate local spending. Under the workforce quality of life criterion, a business is required to satisfy at least two out of three sub-criteria. This includes hiring and retaining a workforce consisting of 70 percent full-time employees, paying part-time employees wages that exceed 55 percent of the state minimum wage at the hire, and/or paying full-time employees wages that exceed the 125 percent of the state minimum wage at the hire. It is important to note that the state minimum wage is currently set at $15.50 per hour and will increase to $16.00 per hour on January 1, 2024, regardless of the size of the employer.

The training criterion will require a business to participate in a recognized High Road Training Partnerships (HRTP) initiative sponsored by the California Workforce Development Board (CWDB). The focus of HRTP is to advance economic opportunities, build economic and environmental resilience, and deliver skills for quality jobs. Specifically, the HRTP are industry-led, worker focused trainings with the intent of addressing critical issues such as equity, job quality, worker voice, industry efficiency, and environmental sustainability. Business participation in a HRTP initiative will help build industry skills for employees and employers alike, and in turn, bolster the local cannabis industry out of its infancy.

The equity business support criterion draws upon the existing "support for equity businesses" provisions required to be provided by non-equity businesses, as stipulated per Section 5.92.1660 of LBMC. The existing requirements do not specify the number of hours of incubation support and shelf space allotted to equity businesses by a non-equity business. Therefore, the equity business support criterion is intended to address this gap and ensure that support is actively being provided to equity businesses. A business will be required to meet at least one out of two sub-criteria, including reserving 15 percent of shelf space reserved for cannabis goods cultivated, manufactured, or delivered by an equity business, or providing 50 hours of incubation support per year to equity businesses.

Implementation

The proposed tax relief will take effect upon amendment of Section 3.80.261 of the LBMC. The one percent tax reduction and three percent tax credit will not be made retroactive. Compared to the City of Santa Ana model, the one percent tax reduction cannot be based on meeting good standing requirements and eligibility criteria, as it is subject to change at any time. The combined tax relief under Tier 1 and Tier 2 may not result in a tax rate less than two percent (or equivalent) for adult-use retail and cultivation businesses. In other words, these businesses would be subject to pay a minimum tax rate of two percent, similar to the City of Oakland model. This scenario (as of now) would only be applicable to equity businesses who pay half the rate set for non-equity businesses.

A business will be required to demonstrate compliance with the eligibility criteria described above through supporting documentation, including but not limited to certified payroll records, proof of participation in a High Road Training Partnership, inventory list, and log of incubation support hours provided to equity businesses. Tax credits will be applied upon remittance of quarterly gross receipts reports and taxes for adult-use retail businesses. This approach is different than the City of Oakland model that rebates taxes back to businesses based on a qualifying period for taxes already paid in the previous tax year. For cultivation businesses, the tax credit will be applied annually upon remittance of taxes for square footage of canopy under cultivation. These tax credit requirements are in alignment with current tax collection practices in the Business License Division and ensures that the local hiring, workforce quality of life, training, and equity business support criteria are being met at the time of tax remittance.

Adult-use retail businesses will be required to pass the tax relief onto the customer. Currently, businesses may opt to pass down the local and state cannabis taxes onto the consumer and reflect it on the receipt at the time of sale. It is unclear whether the reduced costs at checkout for consumers will result in increased sales of legal cannabis and cannabis products; thus, minimizing the consumer base of the illicit cannabis market. While it is critical to lessen the consumer power in the illicit cannabis market, reducing the tax liability for adult-use retail and cultivation businesses is not the end-all solution as other factors impede their ability to succeed. Other factors include the cash-based and private investor reliant nature of the industry due to lack of access to traditional banking services, as cannabis is still listed as a Schedule 1 controlled substance under the federal Controlled Substances Act. The capital-intensive nature of the industry coupled with supply chain constraints such as caps on licenses (especially retail) and prohibition of all cannabis license types in other cities and counties across the state, further impedes the ability for businesses to succeed.

According to the DCC, out of 539 cities and counties in California, 44 percent allow at least one type of cannabis business, 56 percent do not allow any type of cannabis businesses, and 61 percent do not allow any retail cannabis businesses. These limitations on cannabis licensing opportunities throughout the state have contributed to challenging market conditions, and in worst cases, shuttering or sale of businesses. Ultimately, the proposed tax relief plan is intended to help struggling businesses navigate a recently legalized and unique industry with challenging market conditions.

Fiscal Impacts

The proposed tax relief plan is projected to increase the General Fund structural shortfall by $3,060,00 in FY 24. The total fiscal impact is comprised of a $1,080,000 revenue decrease from the one percent tax rate reduction and a cost of $1,980,000 for the Pilot Tax Credit Program. The Adopted FY 24 Budget includes these projected impacts, which will be offset on a one-time basis with previously set-aside Measure MA revenues and other reserves. The potential structural ongoing impact in the outyears (FY 25 and beyond) will be evaluated and addressed as part of future budget development processes. FY 24 budgeted Measure MA revenue assumes $10,920,000, reduced from $12,000,000 budgeted in the prior year. Actual revenue in FY 22 and FY 23 totaled $12,099,297 and $13,052,890, respectively. FY 23 revenue is currently trending lower than the prior two years, which may be attributed to a combination of tax compliance issues, business closures and decrease in sales. Following FY 23 year-end close, total Measure MA revenues will be reviewed and presented to City Council as part of the FY 23 Year-end Budget Performance Report. The appropriation of $1.98 million included in the FY 24 Budget for the Pilot Tax Credit Program will be used to rebate funds back to eligible businesses.

Next Steps

Staff will be returning to City Council in early 2024 with a proposed ordinance that will adopt this proposed plan for implementation. Should this proposal be approved by City Council, staff will monitor over the next two years whether these actions are successful in achieving policy objectives and what the longer-term fiscal impacts are to determine the feasibility of these actions continuing in the future. If you have any questions, please contact Valencia Maria Mota, Manager of Cannabis Oversight/Assistant to the City Manager at (562) 570-5173.

ATTACHMENT: PROPOSED PILOT TAX CREDIT PROGRAM

CC: DAWN MCINTOSH, CITY ATTORNEY
DOUGLAS P. HAUBERT, CITY PROSECUTOR
LAURA L. DOUD, CITY AUDITOR
LINDA F. TATUM, ASSISTANT CITY MANAGER
TERESA CHANDLER, DEPUTY CITY MANAGER
APRIL WALKER, ADMINISTRATIVE DEPUTY CITY MANAGER
TYLER BONNANO-CURLEY, ACTING DEPUTY CITY MANAGER
KEVIN LEE, CHIEF PUBLIC AFFAIRS OFFICER
MONIQUE DE LA GARZA, CITY CLERK
DEPARTMENT HEADS

Attachment

Proposed Pilot Tax Credit Program

<table>
<tr><th colspan="2">Good Standing Requirements</th></tr>
<tr><td colspan="2">• Be complaint with the regulations set by Section 3.80.261 of the LBMC and California Department of Tax and Fee Administration (CDTFA), and cannot have outstanding taxes and fees for any cannabis license associated with the business</td></tr>
<tr><td colspan="2">• Be complaint with the regulations set in Chapter 5.90 and Chapter 5.92 of the LBMC and cannot have pending enforcement action(s) for any cannabis license associated with the business</td></tr>
<tr><td colspan="2">• Be compliant with the regulations set by the Department of Cannabis Control, including the issuance of an active provisional or annual state license</td></tr>
<tr><th colspan="2">Eligibility Criteria</th></tr>
<tr><td>Local Hiring</td><td>• 50% of employees reside within Long Beach</td></tr>
<tr><td>Workforce Quality of Life</td><td>At least two (2) of the following:

• 70% of workforce are full-time employees
• Part-time employees receive wages that exceed 55% of the state minimum wage at the time of hire
• Full-time employees receive wages that exceed 125% of the state minimum wage at the time of hire</td></tr>
<tr><td>Training</td><td>• Proof of participation in a High Road Training Partnership</td></tr>
<tr><td>Equity Business Support</td><td>At least one (1) of the following:

• 15% of shelf space reserved for cannabis goods cultivated, manufactured, or delivered by an equity business
• Provide 50 hours of incubation support per year to equity businesses</td></tr>
</table>