

LEGISLATIVE DIGEST

(Amended in Committee – Second Draft – 7/19/18)

[Initiative Ordinance - Business and Tax Regulations Code - Additional Gross Receipts Tax on Cannabis; Additional Conditions Subjecting Persons to Business Taxes]

Motion ordering submitted to the voters, at an election to be held on November 6, 2018, an ordinance amending the Business and Tax Regulations Code to impose an additional gross receipts tax, starting January 1, 2021, on gross receipts from cannabis business activities, but exempting the first \$500,000 of gross receipts and exempting retail sales of medicinal cannabis; said tax to be between 1% and 5% depending on the type of cannabis business activity and amount of gross receipts, but may be adjusted at any time within a range of 0% to 7% by an ordinance adopted by a two-thirds vote of the Board of Supervisors for any increase (which is limited to 1% annually) or an ordinance adopted by a majority vote of the Board of Supervisors for any decrease; and, starting January 1, 2019, to expand the conditions that subject a person to certain business taxes by including persons with more than \$500,000 in annual gross receipts in the City; and increasing the City’s appropriations limit by the increase in the amount of those business taxes collected compared to the prior year and by the amount collected under the new Cannabis Business Tax, for four years from November 6, 2018.

Existing Law

Businesses engaged in cannabis business activities currently pay a gross receipts tax under Article 12-A-1 of the Business and Tax Regulations Code. The rates vary based on the type of cannabis business activity and the amount of each business’s gross receipts, and range from 0.075% to 0.65%. Businesses with \$1,000,000 or less in total gross receipts within the City (whether from cannabis business activities or any other line of business), adjusted for inflation, are generally exempt from the gross receipts tax in Article 12-A-1. Certain other businesses (e.g., certain non-profits, banks, insurance companies, etc.) are also exempt.

Persons are subject to certain business taxes, including but not limited to business registration, payroll expense, and gross receipts taxes, if they are engaging in business within the City. Persons are considered to be engaging in business in the City if they meet at least one of ten conditions, including maintaining a fixed place of business within the City or soliciting business or providing services in the City for all or part of any seven days during the tax year.

Amendments to Current Law

Beginning on January 1, 2021, this ordinance would impose an additional gross receipts tax on businesses engaging in cannabis business activities in the City (the “Cannabis Business Tax”). Cannabis business activities means any business activities directly related to cannabis or cannabis products, including but not limited to cultivation, possession, manufacture,

processing, storing, labeling, distribution, or sale of cannabis or cannabis products for consideration. Cannabis business activities does not include: (1) business activities indirectly related to cannabis or cannabis products, such as the sale of items that do not themselves contain cannabis; (2) laboratory testing of cannabis; and (3) transportation of cannabis or cannabis products where the person transporting cannabis or cannabis products never takes title to or sells cannabis or cannabis products. Businesses liable for the Cannabis Business Tax would also remain liable for the existing gross receipts tax.

The Cannabis Business Tax rate would be:

- 2.5% for gross receipts from the retail sale of cannabis or cannabis products up to and including \$1,000,000, and 5% for gross receipts from the retail sale of cannabis or cannabis products above \$1,000,000; and
- 1% for gross receipts from cannabis business activities other than the retail sale of cannabis or cannabis products up to and including \$1,000,000, and 1.5% for gross receipts from cannabis business activities other than the retail sale of cannabis or cannabis products above \$1,000,000.

The ordinance would provide rules for how businesses with gross receipts both from the retail sale of cannabis or cannabis products and from cannabis business activities other than the retail sale of cannabis and cannabis products should calculate their Cannabis Business Tax.

The ordinance would permit the Board of Supervisors, by a vote of at least eight members, to increase any or all of the above tax rates, except that each rate could not exceed 7%. The ordinance would also permit the Board of Supervisors, by a majority vote, to decrease any or all of the above tax rates. Any increase in tax would be limited to 1% annually.

The first \$500,000 of gross receipts from cannabis business activities would be exempt from the Cannabis Business Tax. Businesses with gross receipts both from the retail sale of cannabis or cannabis products and from cannabis business activities other than the retail sale of cannabis and cannabis products would be entitled to only one \$500,000 exemption. Additionally, amounts received from the retail sale of medicinal cannabis would be excluded from the calculation of the Cannabis Business Tax. Certain businesses exempt from the existing gross receipts tax (e.g., certain non-profits, banks, insurance companies, etc.) would also be exempt from the Cannabis Business Tax.

All proceeds from the Cannabis Business Tax would be deposited into the general fund and could be expended for any purposes of the City.

On June 21, 2018, the United States Supreme Court in *South Dakota v. Wayfair, Inc.* held that a person no longer needs to have physical presence in a taxing jurisdiction to be subject to that jurisdiction's tax. Effective January 1, 2019, this ordinance would expand the conditions

under which persons are subject to certain business taxes in the City, by also including persons with annual gross receipts in the City exceeding \$500,000, irrespective of physical presence.

This ordinance would also increase the City's appropriations limit under Article XIII B by the increase in the amount of those business taxes collected each fiscal year compared to the prior fiscal year, and by the amounts collected from the Cannabis Business Tax, for four years from November 6, 2018.

Background

This digest reflects amendments made at the Budget and Finance Committee on July 12, 2018. The amendments:

- Removed transportation from the definition of Cannabis Business Activities if the person transporting cannabis or cannabis products never takes title to or sells cannabis or cannabis products;
- For the tax year 2020, reduced the Cannabis Business Tax rate from 2% to 1%;
- For subsequent years, reduced the Cannabis Business Tax Rate from 2% to 1% for gross receipts from cannabis business activities other than the retail sale of cannabis or cannabis products up to and including \$1,000,000, and from 3% to 1.5% for gross receipts from cannabis business activities other than the retail sale of cannabis or cannabis products above \$1,000,000;
- Reduced the voting threshold required to decrease the tax from eight members of the Board of Supervisors to a majority of the members of the Board of Supervisors;
- Reduced the maximum rate up to which the Board of Supervisors could increase the tax from 10% to 7%; and
- Limited any increases to the tax rate to 1% annually.

This digest also reflects amendments made at the Budget and Finance Committee on July 19, 2018. The amendments:

- Effective January 1, 2019, expanded the conditions that will subject persons to certain business taxes by including persons with more than \$500,000 in annual gross receipts in the City; and
- Changed the operative date of the Cannabis Business Tax to January 1, 2021, instead of January 1, 2020.

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