



## City Council Agenda Item

**City Council Meeting Date:** May 18, 2021

**TO:** Honorable Mayor and Members of the City Council

**FROM:** Jim Throop, City Manager  
j\_throop@ci.lompoc.ca.us

**SUBJECT:** Discussion and Direction Regarding Possible Changes to the Commercial Cannabis Taxes Imposed by the City of Lompoc

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### **Recommendation:**

- 1) Determine what, if any, changes to the City's cannabis tax ordinance the City Council wishes to consider placing before the voters for approval at an upcoming election;
- 2) Review the proposed ballot measure and make any suggested modifications;
- 3) Discuss the crafting of a proposed ballot question concerning a change to the current cannabis taxes, based on City Council's proposed changes;
- 4) Direct staff to return with an agenda item to include a final ballot measure and ballot question, to vote on whether to place the measure on an election ballot, and;
- 5) If that direction is given, then staff recommends the City Council also decide what would be the timing and type of election to seek voter approval, or;
- 6) Direct staff to return with additional suggestions or modifications, or;
- 7) Take no action.

### **Background:**

The City Council requested a report on the City's cannabis taxes with options for possible increases and timing of any required ballot measures.

The following taxes are currently applied to cannabis uses:

State excise tax – 15% of retail dispensary sales price

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- State dry weight tax – \$9.25 per oz.
- State/County/Lompoc sales taxes – 8.75% (6% State; 1.75% County; 1% Lompoc)
  - Cultivation (1% of proceeds<sup>1</sup>)
  - Retail dispensaries (6% of proceeds for non-medical transactions)
  - Manufacturing/Distribution (annual flat tax of \$15,000 if net income is less than \$2M, otherwise \$30,000)
- Lompoc Cannabis taxes
  - Microbusiness<sup>2</sup> (based on the above categories with an aggregate limit of 6% of proceeds)
  - Testing (no separate tax)

The following table represents cannabis taxes imposed by various communities throughout the State:

City	Gross Receipts Tax	Square Footage Tax	Comments
City of Santa Barbara	20% gross receipts tax: 5% retail dispensary; 3% manufacturing; 2% cultivation; 1% nurseries; 4% distribution; 44% testing; 8% microbusiness	N/A	
City of Santa Maria	N/A	N/A	Ban on Commercial
City of Atascadero	10% retail 6% gross receipts tax on all other commercial cannabis activities	\$5 per square foot of cultivation facility	Approved 2018
City of Grover Beach	5% on gross receipts of medical related sales and 10% on non-medical	\$25 per sq. ft. on nurseries and cultivation for the first 5,000 sq. ft., then \$10 per sq. ft. for additional. sq. ft.	Future increases tied to the Consumer Price Index (CPI)
City of Morro Bay	10% commercial sales	\$25 per square foot	Approved 2018
City of Paso Robles	10% transportation 15% manufacturing, testing, and distribution 10% dispensaries	\$20 per square foot	Approved 2018
City of Pismo Beach	N/A	N/A	Ban on Commercial
City of San Luis Obispo	6% retail sales 2% distribution 2.5% manufacturing, processing, microbusiness	\$7 per square foot	Effective 1/1/19

<sup>1</sup> Proceeds means total revenue and moneys received by a commercial cannabis activity before any deductions or allowances, including, but not limited to, rent, depreciation, cost of goods sold, labor costs, losses, interest and taxes.

<sup>2</sup> Cultivation on an area less than 10,000 square feet, in conjunction with a licensed distributor, Level 1 manufacturer, and retailer

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City	Gross Receipts Tax	Square Footage Tax	Comments
City of Coalinga	10% gross receipts on retail	\$7 per sq. ft. cultivation; \$25 per sq. ft. manufacturing, distribution, and testing for the first 3,000 sq. ft. then \$10 per sq. ft. for additional. sq. ft., \$2 per sq. ft. nurseries	Adopted 2/3/2018
City of Costa Mesa	4% to 7% gross receipts	N/A	Approved 2020
City of Fillmore	15% gross receipts tax on retail dispensaries	Cultivation \$30 per sq. ft. first 3,000 sq. ft., \$15 per sq. ft. on remainder	Cultivation tax subject to CPI; tax approved 2016
City of Gonzales	5% gross receipts tax on manufacturers capped at 15%	\$15 per sq. ft. cultivation tax capped at \$25	Tax Approved 2016
City of Greenfield	10% gross receipts tax on non-cultivation activities	\$25 per sq. ft. cultivation tax with CPI; \$5 per sq. ft. nurseries	Tax approved 2016
City of Monterey	N/A	N/A	Ban on Commercial
City of Santa Cruz	1% testing laboratories; 2% distribution; 6% cultivation and manufacturing; 7% retail/other	N/A	Approved 2016 and 2019
City of Seaside	Up to 10% gross receipts on cannabis businesses	N/A	Approved 2017
City of Watsonville	2.5% gross receipts tax on manufactured product, 5% retail	\$20 per sq. ft. on cultivation	Tax approved 2016; retail cut in half by City Council 2021
County	Gross Receipts Tax	Square Footage Tax	Comments
Santa Barbara County	6% retail dispensaries, 4% cultivation, 3% manufacturers; 1% nurseries & distributors, 5% microbusinesses	N/A	Effective 7/1/18
San Luis Obispo County	10% retail gross receipts	\$10 per sq. ft. cultivation	Approved 2018
Humboldt County	N/A	\$1 to \$3 per sq. ft. outdoor/indoor, annually	Approved 2016
Lake County		\$1 per sq. ft. outdoor cultivation, \$2 per sq. ft. mixed light, \$3 per sq. ft. indoor	Subject to annual CPI
Mendocino County	2.5% on cultivation, capped at 10% on gross receipts, with minimum determined by square feet of cultivation; 5% on retail; Board considers annual increases, of 2.5% per year, 10% max.	N/A	Annual flat \$2,500 tax, with CPI every year after 7/1/2020 on other cannabis businesses
Monterey County	Not exceed 10% manufacturers, distributors, dispensaries, gross receipts; 1% testing	Not exceed \$15 sq. ft. for indoor cultivation, mixed light cultivation; \$5 sq. ft. nurseries	These are the maximum amounts that are reached by 2021
Santa Cruz County	7% up to 10% on gross receipts	N/A	Initial rate of 7% capped at 10% gross receipts

In response to the City Council's request, this report discusses the various options available for having changes made to the current cannabis tax structure, as well as for the timing and type of elections if voter approval would be required.

## **Discussion:**

### ***Options to Change the City's Cannabis Taxes Structure:***

#### **Eliminating "Tax on a Tax"**

Pursuant to the definition of "proceeds," as set forth in Lompoc Municipal Code (LMC) subdivision 3.50.020 B. 9. (see, footnote 1, above) and as approved by the voters, the City's cannabis tax is assessed against the total price the consumer pays to purchase cannabis in Lompoc, including all state excise taxes and state/county/city sales taxes. If the City Council wants to change those requirements to exclude the sales taxes paid by the consumer, then because that requirement was approved by the voters, it cannot be changed without voter approval. Attachment 1 would provide a vehicle for that change. For a \$100 product purchase, this change would result in business operators paying 6% of \$100 to the City, rather than 6% of the sum of \$100 and all sales taxes and state excise taxes.

#### **Displaying the City's Cannabis Tax on Customer Receipts**

Pursuant to LMC subdivision 3.50.040 E., cannabis taxes are owed by the cannabis business operator and cannot be separately identified or otherwise specifically assessed or charged to any individual customer. If the City Council wants to allow a cannabis business operator to show the cannabis tax on a customer's receipt, then Attachment 1 would provide a vehicle for that change, which would also require voter approval. Note that this change would likely result in retail consumers paying more for the same cannabis products, with no change in the amount the City receives, because business operators are unlikely to lower their base prices due to this change. As an example to demonstrate this concept, currently for a \$100 product, customers pay 8.75% sales tax for a total of \$108.75. After this proposed change, if a business operator does not change their base price, customers would see 8.75% sales tax and 6% city cannabis tax, for a total of \$114.75 for the same \$100 purchase. Under both scenarios, the business operator would pay 6% of \$100 to the City, or \$6.00 (assuming the "tax on a tax" is eliminated, as described above).

#### **Change in Tax Rates**

The City Council may be interested in increasing some or all of the City's current cannabis taxes, including changing the taxes for manufacturing and distribution, by increasing the flat taxes amounts, or imposing a percentage tax. Attachment 1 would provide a vehicle for increasing the taxes paid by all commercial cannabis businesses, except testing, for which no taxes are currently imposed. The City Council could also direct staff to modify

Attachment 1 to establish a tax on cannabis testing businesses. All of those changes would require voter approval.

### ***Election Options<sup>3</sup>:***

There are three types of elections from which the City Council could choose to place a cannabis tax measure before the voters. They are a special election, general municipal election and mail-in only election.

#### Special Election:

This type of election is defined as an election held on any date other than the City's general election, which is held the first Tuesday after the first Monday in November of each even-numbered year. Pursuant to Elections Code (EC) section 1002, a special election must be held on the same date as any other established election date, as set by EC section 1000. Those established election dates are the (i) first Tuesday after the first Monday in March of each even-numbered year that is evenly divisible by four, (ii) first Tuesday after the first Monday in March of each odd-numbered year, (iii) second Tuesday of April in each even-numbered year; (iv) first Tuesday after the first Monday in June in each even-numbered year that is not evenly divisible by four, and (v) first Tuesday after the first Monday in November of each year.

The next available of those established dates would be November 2, 2021, April 12, 2022, or June 7, 2022. Pursuant to Proposition 218, however, since the measure would involve general taxes, an election on those dates could only be held if the City Council votes unanimously to declare there is a fiscal emergency that demands the timing of that election [Cal. Const. Art. 13C, § 2(b)].

If the City Council wants a cannabis tax measure to be held at a special election, then the City Council could call a standalone election for November 2, 2021, with the deadline for calling that election being August 6, 2021. The City Council could also call a standalone election for April 12, 2022, with the deadline for calling that election being January 15, 2022. If the special election were to be consolidated with the next countywide election, to be held on June 7, 2022, then the deadline for the City Council to call that election would be March 11, 2022; but please note due to the delay in the release of the 2020 census data, those June and March dates may be extended.

#### General Election:

The next general election for the City is November 8, 2022. If the City Council decides to go forward with changes to the City's cannabis tax structure at that election, then the City must call and approve all the documents required for placing an item on the ballot for that election on or before August 13, 2022. A vote of four City Council Members would be needed to place the measure on the November 8, 2022, ballot [Gov. Code 53724(b)].

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<sup>3</sup> Because the City's cannabis taxes are considered general taxes, this staff report only discusses the various options applicable to those types of taxes, as opposed to special taxes, which allow or require some different procedures.

Mail-in Only Election:

This type of an election, as the name indicates, would be conducted without any polling places and completed simply by the return of mailed ballots. Such an election is authorized, by EC subdivision 4000(c)(8), for a measure involving City taxes. Pursuant to Election Code section 1500, such elections can only be held on the (i) first Tuesday after the first Monday in May of each year (May 3, 2022) or (ii) the last Tuesday in August of each year (August 31, 2021, or August 30, 2022). Pursuant to Proposition 218, since the measure would involve general taxes, a mail-in only election on those dates could only be held if the City Council votes unanimously to declare there is a fiscal emergency that demands the timing of that election [Cal. Const. Art. 13C, § 2(b)].

The City could conduct this type of election itself, with the help of an election consultant and additional temporary workers, during the election period. To have the mail-in election on August 31, 2021, the City elections official must, no later than 29 days before the day of the election, provide the ballots, and supplies necessary for the use and return of the ballots, to every registered voter in the City.

Summary of Election Options:

Type of Election	Available Dates	Council Member Votes Required	Deadline to Call Election (88 days prior)
General	November 8, 2022	4	July 13, 2022
Special	November 2, 2021 April 12, 2022 June 7, 2022	5	July 8, 2021 January 15, 2022 March 11, 2022
Mail-in Only	August 31, 2021 May 3, 2022 August 30, 2022	5	June 4, 2021 February 4, 2022 June 3, 2022

Fiscal Impact:

To date, the amount of revenue the City has received in annual revenues from its cannabis taxes was \$126,251.64 in 2019, \$983,513 in 2020 and \$1,009,211 in 2021 year-to-date (YTD), with an estimated total of \$1,500,000 for 2021. Of those amounts, dispensary operations accounted for all the cannabis revenue in 2019 (there were no other types of businesses operating), \$923,513 in 2020 and \$934,211 YTD, and manufacturing and distribution accounted for \$60,000 in 2020 and \$75,000 YTD.

The cost to the City for having the tax measure on the ballot for November 2, 2021, would be approximately \$70,000, plus added costs for poll workers and rental for four to six polling locations, polling booths and voting machines, which those costs are currently being researched. These costs are because that would not be a consolidated election with the County. If the April 12, 2022, or June 7, 2022, elections were consolidated with the County, then the estimate for those is about \$24,000, based on the invoice for the

March 2020 consolidated election for the 2020 tax measure (Measure 1). If the tax measure was to be on the next general municipal election, November 8, 2022, then that cost would be about \$60,000, most of which would be spent for the Mayoral and Council Member elections, regardless of a cannabis ballot measure. If it was to be a mail-in only election on August 31, 2021, May 3, 2022, or August 30, 2022, then that cost would be approximately \$70,000, including hiring four temporary employees for two weeks; but that does not include an amount for any possible educational outreach on the ballot measure.

In terms of what an updated cannabis tax would bring to the City, as an example of a 5% tax on manufacturing, distribution, and cultivation<sup>4</sup>, which is the current industry average, the City would expect to receive approximately \$3,000,000 in additional tax revenue for 2021.

Expanding on this hypothetical example, the City currently has applications for 10 manufacturing companies, 12 distribution companies, 4 processing companies, and 2 cultivation companies<sup>5</sup>, for a total of 28 companies, which would not currently be taxed. If an assumption was made that each company grossed \$10 Million per year, which is not unheard of earnings potential, then that equates to \$280,000,000 in total gross revenue. At an industry average tax rate of 5%, this would be an additional \$14,000,000 in General Fund revenue. This, again, is just an illustrative example. Another example, would be that for every \$10,000,000 in cannabis gross revenue, at a 5% tax rate, it would equate to \$500,000 in new General Fund revenue.

**Conclusion:**

The City Council is requested to provide direction regarding the percentage amount of the taxes that could be applied to each commercial cannabis activity and whether there will be changes as to how those taxes are assessed, as well as what information about those taxes may be included on a customer's receipt.

In addition, the City Council is requested to provide direction as to whether the ballot measure required to establish those changes should be placed on the next general municipal election, a special election, a special election with mail-in only ballots, or to continue further discussions.

Respectfully submitted,

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Jim Throop, City Manager

Attachments: 1) Proposed Ballot Measure Ordinance re cannabis taxes  
2) Rough draft of ballot question

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<sup>4</sup> Cultivation is currently taxed at 1%.

<sup>5</sup> See Footnote 4.