



STAFF REPORT
2/23/2022

TO: Honorable Mayor and City Council

FROM: Nathan Statham, Finance Director

SUBJECT: Set Cannabis Business Tax Rates and Implement a Cannabis Tax Abatement Program

STAFF RECOMMENDATION:

Staff recommends that City Council adopt resolution 2022-22 setting City wide cannabis business tax rates and implementing a tax rebate structure to encourage cannabis business growth within the City.

BACKGROUND:

In November of 2016 City voters passed a Cannabis Tax Measure. That tax measure set maximum tax rates of 6% for all cannabis businesses and \$15 per square foot of production area for cultivation and manufacturing businesses. City Council entered into a development agreement in July of 2017 that lead to the current tax rate structure shown below:

Square Footage Tax – cultivation and manufacturing 20,000 sq. ft. or less \$15 per square foot of production area annually and

Gross Receipts Tax –cultivation 4%, retail 6%, manufacturing 2%, distribution 2%, testing 1%.

This structure resulted in roughly \$1.9 million in cannabis business tax collections in fiscal year 2021.

DISCUSSION/ANALYSIS:

The current tax rate structure was implemented for a newly legalized, rapidly evolving industry. City Council reviewed the current tax rates and structure and compared them to other Coachella Valley Cities at a study session on January 31, 2022. Comparisons with other Coachella Valley Cities and input from the cannabis business community pointed out some disparities in the City's current cannabis tax rates. Council also reviewed tax related mechanisms to encourage growth in the cannabis business sector in the City through lower tax rates and incentive programs.

The rate comparison between the City of Coachella and other valley cities is shown below:

	Coachella*	Valley Cities **
Cultivation	5%	1.5%
Retail	6%	10%
Manufacturing	2%	1%
Distribution	2%	0%
Testing	1%	0%

* Includes square footage component as part of percent of gross receipts for cultivation.

**Represents the average percentage of gross sales for Palm Desert, Palm Springs, Cathedral City and Desert Hot Springs.

The proposed tax rate structure would bring the City in line with other Coachella Valley Cities by eliminating the square footage tax for cultivation and manufacturing, eliminating the distribution and testing taxes and lowering the cultivation tax rate.

The proposed tax rates and structure is:

- Cultivation - set to 4% of gross receipts in 2022
- set to 3% of gross receipts in 2023
- set to 2% of gross receipts in 2024 provided tax revenues meet 2021 levels

Retail – set to 6% of gross receipts

Manufacturing – set to 2% of gross receipts

The City has found it advantageous to offer lower tax rates in certain instances to encourage cannabis businesses to locate in the City. This has been done through conditions in entitlement process documents. It would be more advantageous to the City to have a formalized process in place to encourage new or expansionary development in the City. The basis of such agreements should be overall benefit to the City.

The recommended tax abatement program would allow the City to determine if a business provides an economic benefit to the City and only rebate tax revenues if those benefits actually occur. The program would be structured to allow for up to a 50% rebate of collected taxes in the first two years of operations provided employment and/or sales levels collectively determined to provide a benefit to the City are met. Having a formalized program in place would provide a procedural means for new development to bring proposals for tax advantages that exceed the standard program guidelines to City Council for consideration.

FISCAL IMPACT:

The propose tax rate reductions for 2022 and 2023 would reduce tax revenues by \$245,000 per year if the tax base remains unchanged (no increases in sales for existing businesses and no new businesses open). The City expects increases in sales and new businesses based on current market conditions and developer activity. Increased business activity in the City is expected to largely offset the reduction in current tax rates. This presumes a continued favorable economic outlook.

The proposed tax rate reductions for tax year 2024 would reduce tax revenues by \$245,000, but would only take effect if overall cultivation tax levels have recovered to at least tax year 2021 levels. This would ensure that no decrease in rate occurs unless the City has tax revenues in place.

Tax abatements would have no fiscal impact in that the applicable revenues would be new revenues to the City. While the lower tax rate would bring in less tax revenue than would be generated without the tax abatement, it is less likely that the business would locate within the City without the tax abatement.

ALTERNATIVES:

1. Approve resolutions 2022-22 as recommended.
2. Refer the matter back to City staff for further analysis or the development of alternative tax rates and structures.
3. Modify individual rates and criteria within the proposed tax structure and approve resolution 2022-22 as amended.

ATTACHMENTS:

1. Resolution 2022-22