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January 6, 2025

Honorable Members of the Los Angeles City Council
c/o Office of the City Clerk
200 North Spring Street, Room 395
Los Angeles, CA 90012

RE: REPORT FROM THE OFFICE OF FINANCE REGARDING MOTION 24-1447

Dear Honorable Members:

Council File 24-1447, initiated by Motion (Padilla-Hutt), instructed the Office of Finance (Finance) and the Department of Cannabis Regulation (DCR), with the assistance of the City Attorney, to “report with recommendations to align the City’s definition of gross receipts tax with the provisions of Senate Bill 1059, as well as to report on the potential impact on the City’s revenues relative to the collection of business taxes for cannabis and cannabis-related products.”

This report provides information regarding Finance’s current plan to implement Senate Bill 1059 (SB 1059) as well as a discussion of the anticipated revenue impact. It also provides recommended language that the Council can use to request the City Attorney to prepare and present ordinances to align the City’s municipal code with SB 1059.

BACKGROUND

On September 28, 2024, Governor Newsom signed California Senate Bill 1059 which added new Section 16005 to the California Business and Professions Code. The changes introduced by the bill will directly impact how cannabis operators calculate and report their taxable receipts.

Under current State law, the definition of gross receipts for the purpose of calculating State excise tax on cannabis sales includes any amount calculated to cover local business tax. Under current City law, which was adopted by the voters as part of Proposition M in 2017, the definition of gross receipts for the purpose of calculating City



business tax on cannabis sales includes any amount calculated to cover State excise tax. SB 1059 changes this by prohibiting local jurisdictions from including the State excise tax in their definition of gross receipts, effective January 1, 2025.

This means that, while the State will have the ability to include receipts collected to cover City business tax in their calculation of the excise tax, the reverse will no longer be true.

IMPLEMENTATION

Finance worked with the City Attorney to prepare a letter to registered cannabis businesses detailing the City's implementation of SB 1059. The letter was mailed out in the first week of December. The relevant details of this implementation are as follows:

1. **Effective Date:** The provisions of SB 1059 will take effect on January 1, 2025. The updated methodology will apply to the February 2025 tax filing deadline, which pertains to receipts from January 2025. Cannabis operators should ensure they are familiar with the new tax calculation and reporting requirements imposed by SB 1059 that will be in place from this date forward.
2. **Excise Tax Exclusion Starting January 1, 2025:** Beginning January 1, 2025, cannabis operators should no longer include the state cannabis excise tax as part of their taxable receipts when reporting its gross receipts to the City.
3. **Excise Tax Inclusion until December 31, 2024:** Until December 31, 2024, cannabis operators are required to include the excise tax as part of gross receipts when calculating taxes as City law requires. The excise tax must continue to be factored into gross receipts for City tax reporting purposes until the end of this year.
4. **City-Imposed Taxes Remain Taxable:** While SB 1059 provides that the state excise tax will no longer be included in computing and measuring a cannabis operator's taxable receipts starting in 2025, the City's cannabis gross receipts tax on cannabis operators is not otherwise impacted by SB 1059. SB 1059 did not impair or prohibit the imposition or collection of any local tax from cannabis sales.

Because the State code supersedes the City's code, no changes to the Los Angeles Municipal Code (LAMC) are necessary in order to effectuate the new law. However, in the interest of transparency and clarity on how to calculate City tax due, the Council may wish to revise the LAMC to be consistent with SB 1059. Language requesting the City Attorney to prepare and present the necessary ordinances is included in the recommendation should the Council wish to move in that direction.

REVENUE IMPACT

The current tax structure results in 34.75 percent tax on cannabis retail sales. This is comprised of 9.75 percent sales tax, 10 percent City business tax, and 15 percent State excise tax. Sales tax is already excluded from the business tax calculation per State

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law, so the taxable gross receipts are 125 percent of the base sale price. Once SB 1059 takes effect in January, this percentage will drop to 110 percent, a reduction of 12 percent.

The City's 2024-25 Adopted Budget assumes \$94 million from Cannabis business tax. Twelve (12) percent of this total would be \$11.3 million annually. However, since the new law is effective January 1, 2025, and cannabis business taxes are due the month following, no impact will be seen until February, and only five months of the current fiscal year will be impacted. This makes the current year estimate no more than \$4.7 million. Reducing this estimate further is the current trend for overall cannabis business tax which, through the first five months of the year, is lagging well under budget. Due to this trend, we estimate that the current year impact of SB 1059 will be approximately \$3-4 million.

RECOMMENDATION

Should the Council wish to amend the LAMC to align the City's cannabis business tax code with the provisions of SB 1059, it is recommended that the Council:

REQUEST the City Attorney to prepare and present an ordinance amending LAMC Section 21.51a(4) to specifically exclude the State excise tax from the definition of gross receipts.

Sincerely,



Diana Mangioglu
City Treasurer / Director of Finance