



County of Monterey

Item No.

Board Report

Board of Supervisors
Chambers
168 W. Alisal St., 1st Floor
Salinas, CA 93901

Legistar File Number: 22-1026

November 08, 2022

Introduced: 10/28/2022

Current Status: Agenda Ready

Version: 1

Matter Type: General Agenda Item

- a. Receive a status update on the commercial cannabis industry's ability to pay delinquent and current taxes due on or before January 31, 2023; and
- b. Consider commercial cannabis business cultivation tax rate options; and
- c. Consider a formal commercial cannabis business payment plan, including requirements and actions if the payment plan is found to be in default; and
- d. Authorize the Treasurer-Tax Collector to record liens for commercial cannabis cultivation business tax for the period of FY 21-22 Q2-Q4, and FY 22-23 Q1 to be released upon payment in full; and
- e. Reaffirm the authority of the Director of Housing and Community Development and authorize the Director to deny cannabis land use permit applications without prejudice if they have remained incomplete for a period of six months or longer; and
- f. Provide further direction as appropriate.

RECOMMENDATIONS:

It is recommended that the Board of Supervisors:

- a. Receive a status update on the commercial cannabis industry's ability to pay delinquent and current taxes due on or before January 31, 2023; and
- b. Consider commercial cannabis business cultivation tax rate options; and
- c. Consider a formal commercial cannabis business payment plan, including requirements and actions if the payment plan is found to be in default; and
- d. Authorize the Treasurer-Tax Collector to record liens for commercial cannabis cultivation business tax for the period of FY 21-22 Q2-Q4, and FY 22-23 Q1 to be released upon payment in full; and
- e. Reaffirm the authority of the Director of Housing and Community Development and authorize the Director to deny cannabis land use permit applications without prejudice if they have remained incomplete for a period of six months or longer; and
- f. Provide further direction as appropriate.

SUMMARY/DISCUSSION

A growing number of commercial cannabis businesses are failing to pay local and state taxes, both statewide and in other states where commercial cannabis is legal. These operators have requested to defer their tax bills to meet other pressing needs, such as paying employees and funding expenses related to meeting local and state licensing requirements. With few exceptions, cannabis operators in Monterey County have made timely cannabis business tax payments since Fiscal Year (FY) 16-17 before the delinquency rate rose to 19% in Q1 of FY 21-22. This period coincides with the market

downturn that became apparent in July 2021.

For FY 21-22, commercial cannabis business taxes have a balance due of approximately \$2.8 million, although the Board of Supervisors (Board) has approved a conditional waiver of penalties and interest that would otherwise accrue for Q2 - Q4 if payment is made on or before January 31, 2023. Also, there is a delinquent balance of commercial cannabis business taxes for FY 20-21 that equals to \$145,142 and FY 21-22, Quarter 1 at \$1,215,404.

The Board has continuously provided relief to the industry by allowing multiple canopy modifications, removing automatic rate increases, reducing commercial cannabis cultivation and distribution tax rates, waiving penalties and interest, and effectively extending the due date of FY 21-22, Quarters 2-4 payments to January 31, 2023. At the Board meeting on October 18, 2022, the Program proposed a resolution on the consent agenda to conditionally waive interest and penalties for FY 22-23, Quarter 1 if paid on or before January 31, 2023. The item was pulled for discussion and not acted upon. Instead, the Board directed the Program to devise a payment plan program and return to the Board within 30 days.

As directed, the Program has returned to discuss both the payment program and the following related issues:

- Commercial Cannabis Business Cultivation Tax Rates.
- Impacts of the payment plan to the Provisional Cannabis Business Permit (Ordinance 5376) and Non-Codified Good Standing Criteria.
- Redefining permissions to operate.

Commercial Cannabis Business Cultivation Tax Rates.

The Program has presented a series of commercial cannabis business tax rate options since December 2021. In March 2022, the Board adopted Ordinance 5371, which removed automatic rate increases and reduced cultivation and distribution tax rates retroactive to January 1, 2022, as follows:

- Indoor \$7.00 per square foot.
- Mixed-light \$3.00 per square foot.
- Nursery \$1.00 per square foot.
- Distribution 0% of gross receipts.

At the May 17, 2022, Board meeting, staff presented options to amend MCC 7.100 and was directed to return to the Board in early June 2022 to review the impacts that lowering cultivation rates would have on the FY 21-22 and FY 22-23 budgets. Below are the rates that were adopted retroactive to October 1, 2021, via Ordinance 5384:

- Indoor \$3.00 per square foot.
- Mixed-light \$2.00 per square foot.
- Nursery \$1.00 per square foot.

At the August 23, 2022, Board meeting, the Board received public comment from the industry and the Monterey County Cannabis Industry Association.

The industry proposed the following commercial cannabis business cultivation rates to maintain recovery of Program costs, which are projected at \$6.5m for FY 22-23.

- Indoor \$2.55 per square foot.
- Mixed-light \$1.70 per square foot.
- Nursery \$0.85 per square foot.

The Monterey County Cannabis Industry Association proposed the following commercial cannabis business cultivation rates:

- Indoor \$1.50 per square foot.
- Mixed-light \$1.00 per square foot.
- Nursery \$0.50 per square foot.

Commercial Cannabis Business Cultivation Payment Plan.

The commercial cannabis business tax is an annual tax, due and payable in quarterly installments. The commercial cannabis industry has repeatedly stated they are in financial crisis, and many will shut down their operations. A formal payment plan would allow the County to receive some of the tax delinquency before the operator closes.

At the direction of the Board, the Program recommends the following formal payment plan that would include all commercial cannabis business cultivation taxes owed from Q2 of FY 21-22 through Q1 of FY 22-23:

- Implemented and monitored by the Program, with payments collected by the TTC.
 - Operators would be required to submit an “Authorization to release confidential tax information” form that would enable the TTC to communicate tax information to the Program.
- Formal payment plan duration: December 1, 2022 - June 30, 2023.
 - This would require staff to return to the Board to extend the conditional waiver of penalties and interest through June 30, 2023.
- Operators are required to pay 25% of commercial cannabis business cultivation taxes owed no later than November 30, 2022, which is estimated at \$1,412,681.56.
- The remaining tax amount due will be collected in a formal payment plan with payments due on the 1st of each month, which is estimated at \$4,238,044.67.
 - If the due date falls on Saturday, Sunday or a holiday, the due date shall be the next regular business day on which the County is open to the public.
- Penalties and interest are applied to unpaid tax balances and are removed upon receiving payment in full.
- Treasurer-Tax Collector shall record liens for FY 21-22 commercial cannabis business tax to include penalties and interest. Liens will be released upon full payment of the cultivation taxes due. In addition, the Treasurer-Tax Collector shall record liens after each FY 22-23 quarter, including penalties and interest, in order to memorialize the amounts due and codify our ability to seize business assets if the amounts are not paid as agreed in the payment plans.
- On default, all unpaid commercial cannabis cultivation taxes could be collected through a litigation process if the Board directs staff accordingly.
 - The business would need to coordinate with the Program to shut down operations and

follow the process of business closure.

The provisions above are recommended by staff and the options below have been prepared for consideration by the Board.

Option 1: Reduce cannabis cultivation tax rates to zero for the remainder of FY 22-23 or include these periods within the formal payment plan.

Because the commercial cannabis market remains saturated and the wholesale price points have not improved since 2021, reducing cultivation tax rates to zero for the remainder of FY 22-23 could allow operators to recover and stabilize while they meet local requirements to transition to state annual licensure. A broader view of the pricing decline in the cannabis market can be seen in Attachment B and although this information is comprised of the entire United States, the trends closely mimic what we have observed locally.

This action would be similar to a previous staff recommendation that was made by the Program and supported by the Treasurer-Tax Collector (TTC) at the July 26, 2022, Board meeting to waive cultivation taxes for FY 21-22 Q2 - Q4.

- Cultivation tax revenue for FY 22-23, Q2 - Q4 is estimated at \$5,426,276.
- It is likely that operators will face similar difficulty in paying these taxes when they become due.

If the Board does not wish to reduce cultivation rates to zero for the remainder of FY 22-23 or include any of these periods in the proposed formal payment plan, staff anticipates that they will again need to return to the Board to address the inability of the industry to timely pay these installments. The action the Board takes on this option will directly impact the future of commercial cannabis activities within Monterey County, along with the employment opportunities and tax revenue they generate.

Option 2: Waive up to 50% of the commercial cannabis business cultivation taxes owed during the amnesty period for FY 21-22.

This amount is estimated at \$2,761,171.62. It should be noted that significant staff time would be required to process refunds owed to operators who timely paid.

Redefining permissions to operate.

Program and TTC staff consider operators delinquent if they have not timely paid the entirety of all taxes owed. Below are the sections of MCC that prohibit an operator from remaining operational while delinquent:

- MCC 7.90.070(F)(3):
“Any application for modification or renewal shall be denied if: The permittee is delinquent in payment of any state, County, or other local taxes.”
- MCC 7.90.100(A)(21):
“A permittee shall not be delinquent in the payment of all applicable state taxes and fees, County taxes and fees, and other local agencies’ taxes and fees.”
- MCC 7.90.130(G):
“Failure to pay all applicable taxes and fees required by the state, County, or other local

agencies.”

- MCC 7.02.150(A)(4):
“The applicant is delinquent in payment of County taxes, fines or fees associated with said business.”
- MCC 7.02.160(A)(5):
“Failure to pay business property taxes or business license taxes or fines or penalties associated with said business when due and payable.”
- MCC 7.100.080:
“Unless otherwise specifically provided under other provisions of this Chapter, the taxes required to be paid pursuant to this Chapter shall be deemed delinquent if not received by the Treasurer-Tax Collector on or before the due date as specified in Sections 7.100.060 and 7.100.070.”

Staff is seeking direction from the Board on how delinquent operators should be handled, specifically, if shutdown procedures should begin immediately upon delinquency of any applicable taxes, or if a grace period to become current should be established.

Impacts to the Provisional Cannabis Business Permit (Ordinance 5376) and Non-Codified Good Standing Criteria.

The failure to timely pay any taxes due has a related and equally serious consequence. Operators who are delinquent would be disqualified from the Board’s recently approved Provisional Cannabis Business Permit Program (PCBP Program), which will supplant the good standing regime. Although good standing will be going away, entry into the PCBP program is tied to existing good standing criteria, a choice necessary to clearly define the class of PCBP program participants. The relevant good standing criterion is number 3, which reads as follows:

“The subject property and business must be current on all applicable taxes. Pursuant to the Board of Supervisor’s decision to extend the conditional waiver of penalties and interest for Fiscal Year 21-22 Q2 - Q4, operators who owe for those quarters will not be removed from Good Standing. Operators should make every effort to submit monthly payments and to pay in full on or before January 31st, 2023, to be eligible for the conditional waiver of penalties and interest. If the taxes owed from FY 21-22 are not paid in full by January 31st, 2023, or the operator becomes delinquent for any quarter in FY 22-23, the operator will no longer be in Good Standing.”

This criterion applies not only to County commercial cannabis taxes, but also to the Monterey County Regional Fire District (MCRFD) commercial cannabis tax. MCRFD currently has 32 active commercial business operators in their district and reports a 58% delinquency rate, with 4 operators on payment plans. Below are the delinquent balances by calendar year for MCRFD:

- 2021 \$188,594.52
- 2022 Q1 - Q2 \$119,209.33

Good standing criteria is a staff creation, so staff can amend it without Board action. Contingent upon the adoption of a payment plan program, the Program would amend criterion number 3 as follows:

“The subject property and business must either be current on all applicable taxes or be enrolled in the payment plan program.”

Once good standing is replaced by the PCBP, delinquent operators would be operating without County authority and be potentially subject to immediate shutdown. Staff could, at the Board’s direction, amend existing good standing criteria to avoid this result, but allowing businesses to operate while delinquent would likely disincentivize them to pay outstanding taxes owed and could be seen as inequitable to other operators that have and will paid their taxes timely. The Board should discuss this matter and provide direction to staff.

Moreover, Ordinance 5376, authorizing the issuance of temporary commercial cannabis provisional permits, does not explicitly state that the Program would provide local authorization to the DCC to transition from provisional to annual licensure. The Board should provide further direction to staff if it desires to use the authority provided in Ordinance 5376 to grant local authorization to transition operators from the provisional state license to its annual license. If the Program were to provide local authorization and the permittee did not meet local requirements by the time the PCBP expires, the County may be in a compromised position because a state annual license may be active without meeting certain local requirements. Operators would be in violation of the county code due to the lack of local compliance, however there is limited means to request revocation of a state license.

The County would rely upon its local enforcement authority to revoke local permits and/or close operations. The resources, time, and dollars required to shut down a business operation after it has received a state annual license would exceed staff budgets and workload. Working to shut down a limited number of operations has been complex, requiring careful handling of cannabis plants that are left on site both before and after the state license is expired or revoked. It should also be noted that in recent business closures, the business owners cease all communication with the Program.

The Board should also discuss and provide direction regarding land use permit applications that have remained incomplete for more than six months. For those applications that have remained incomplete for over six months, the Housing and Community Development Department could deny those applications without prejudice and clarify the perception that there is a backlog of incomplete applications. Some operators have expressed that the applications are not moving forward but have not formally withdrawn the applications. Staff seeks the Boards direction on this matter.

Next steps.

After the Board has given direction on which option(s) to further develop unless it is intended to remain with the status quo, the Program, Office of the County Counsel, and the Treasurer-Tax Collector’s Office, and Housing and Community Development will closely collaborate to implement the Board’s direction.

OTHER AGENCY INVOLVEMENT:

The CAO Executive Management, Office of the County Counsel, CAO Budget Office, and Treasurer Tax Collector’s Office met on October 26, 2022, to discuss the issue, share input, and address any concerns stemming from the proposed options. Additionally, the Monterey County Regional Fire

District was interviewed by the Program Manager.

FINANCING:

Further amendments to Chapter 7.100 could reduce the estimated commercial cannabis tax revenue for FY 22-23 by an amount to be determined by the policy direction provided by the Board. The impact of additional tax relief options provided in this report range from no impact to a \$8.2m reduction.

BOARD OF SUPERVISORS STRATEGIC INITIATIVES:

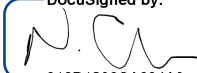
The Monterey County Cannabis Program addresses each of the Strategic Initiative Policy Areas that promote the growth of a responsible and legal Monterey County cannabis industry.

Mark a check to the related Board of Supervisors Strategic Initiatives

- X Economic Development
- X Administration
- X Health & Human Services
- X Infrastructure
- X Public Safety

Prepared by: Joann Iwamoto, Program Manager II

Approved by: Nicholas E. Chiulos, Assistant CAO

DocuSigned by:

910D1286CA694A8...

Attachment A: Ordinance 5376

Attachment B: United States Cannabis Spot Index