



# County of Monterey

**Item No.**

## Board Report

Board of Supervisors  
Chambers

168 W. Alisal St., 1st Floor  
Salinas, CA 93901

**Legistar File Number: 22-1147**

**December 07, 2022**

**Introduced:** 11/30/2022

**Current Status:** Agenda Ready

**Version:** 1

**Matter Type:** General Agenda Item

- a. Review options to reduce commercial cannabis cultivation business tax rates; and
- b. Direct the Cannabis Program to return to the Board of Supervisors for consideration of an amendment to Monterey County Code 7.100 with the approved amended commercial cannabis business tax rates; and
- c. Revise the formal payment plan by reducing the 25% down payment to 15% and delaying the due date to make the down payment to on or before January 31, 2023; and
- d. Provide further direction as appropriate.

### RECOMMENDATIONS:

It is recommended that the Board of Supervisors:

- a. Review options to reduce commercial cannabis cultivation business tax rates; and
- b. Direct the Cannabis Program to return to the Board of Supervisors for consideration of an amendment to Monterey County Code 7.100 with the approved amended commercial cannabis business tax rates; and
- c. Revise the formal payment plan by reducing the 25% down payment to 15% and delaying the due date to make the down payment to on or before January 31, 2023; and
- d. Provide further direction as appropriate.

### SUMMARY:

At the November 8, 2022, Board of Supervisors (Board) meeting, the Cannabis Program (Program) was directed to schedule a Special Cannabis Committee (Committee) meeting in the November and request time at the November Board meeting to present Committee recommendations on proposed amendments to commercial cannabis cultivation business tax rates. Additional direction was provided to include a concept discussed at a prior Committee meeting-scaled tax rates driven by wholesale pricing-within the proposed cultivation tax rate amendments.

### DISCUSSION:

During their presentation to the Board on November 8, 2022, the Program presented the current commercial cannabis cultivation business tax rates and the rates previously proposed through public comment by the cannabis industry and Monterey County Cannabis Industry Association in August. For context on how rates have changed over time, staff have prepared a retrospective on local cultivation tax rates in Attachment A.

As the Program has presented at various meetings, the commercial cannabis industry has not stabilized. The industry is facing a crisis throughout the State of California and a growing number of operators are failing to pay local and state taxes. These operators have requested to defer their tax

liabilities so that they may fund other pressing needs, such as payroll and expenses related to meeting local and state licensing requirements. There have been 33 business closures since Fiscal Year (FY) 16-17, including 7 in FY 22-23. Annually, these closures collectively represent losses of approximately \$1.3m in commercial cannabis cultivation business tax revenue and 500 jobs.

The reality of our commercial cannabis industry is daunting, but these statistics offer the Board a realistic picture of the commercial cannabis industry in Monterey County, which also mirrors local jurisdictions throughout the state. The industry has provided public comment many times over, requesting forms of relief that could assist them to continue operations during these very trying times.

The Program has prepared the proposed scaled cultivation tax rates in Attachment B, where rates begin at the recovery of Program costs at current canopy and raise in two wholesale price-based increments. These increments, if reached, would provide the County with a revenue surplus of approximately \$500k each.

While this sliding scale rate concept could reduce the frequency with which the Program seeks Board direction on commercial cannabis taxation, staff believes the concept has the following strengths and weaknesses:

Strengths:

- Provides further relief to cultivators and establishes a benchmark for cultivators to factor into their business plans.
- The County and its cultivators will benefit as prices recover.

Weaknesses:

- Because staff did not have a comparable taxation method or outcomes to base the model upon, it will likely be implemented and accompanied with trial and error.
  - Although the sliding scale concept is used in traditional agriculture, the data captured by the United States Department of Agriculture is reliable enough for both the buyer and seller to base the pricing of sales contracts on.
  - The sliding scale concept needs further review by the Office of the County Counsel before the Board adopt this concept.
- The accuracy of pricing information currently available to the Program via the California Cannabis Authority (CCA) continues to be contested and staff anticipates that it will be difficult to come to a consensus on when a rate increase is warranted.
  - The CCA Platform is only allowed to ingest data as submitted by operators; incorrect or inaccurate information flows through the platform, which is unable to resolve errors without operator intervention.
    - This conscious design choice preserves the integrity of the source data and prevents any manipulation or editorialization of the data.
    - While the industry frequently expresses concerns that pricing figures are inflated or incorrect, pricing figures are driven by operator data.
    - A local operator recently and incorrectly reported tens of thousands of plants as a negative number, which caused the public facing Transparency Project to go briefly negative until those incorrect values could be excluded from public

- facing report; at the time of this writing, those values remain negative.
- CCA data is limited because operators were only required to submit monthly reports on pricing related to external transfers (transfers to licenses not owned by, or related to, the transferring license) until November 2022 when the Program began requiring all operators to submit price points for all sales, whether the transfer of product was an internal transfer (between related licenses) or external transfers.
    - For October 2022 submittals, CCA received 60% of the required monthly data.
  - Operators enter the values they expect to receive when selling on consignment, however they are not consistently updated with what was received and this contributes to disparities in the data.
  - Some industry members believe, because the price point data is self-reported by the individual operators, that unless it is audited, the monthly data submitted by operators could be incorrect.
  - The inconsistent submission of monthly CSVs by the industry as well as operators who are noncompliant in their monthly reporting, creates inaccurate data.
  - Staff believes that regulatory efforts will be significantly more effective if these collective data issues are rectified.
- Due to the volume of business closures observed recently and the variable nature of cultivation canopy, cost recovery cannot be guaranteed because operators may cease operations or reduce their canopy below the current projections that the proposed recovery rates are based on.
  - There will continue to be operating costs outside of County control, such as ownership of the underlying property or economies of scale, that could prevent a cultivator from being viable even at cost recovery rates.
  - Commercial cannabis cultivation business tax rate amendments, depending on the frequency, could require significant staff time to administer.
  - There are potential legal issues with the plan, including some raised by a local attorney; County Counsel will need time to thoroughly research and analyze this issue to ensure such a plan's legality.

Should the Board wish to proceed with the sliding scale concept, the Program recommends the following measures to assist with implementation:

- Commercial cannabis cultivation business tax rates shall be amended no more than once per quarter, as multiple tax rate changes in a single quarter creates challenges in ensuring the proper tax rate was applied.
- The Board may wish to establish a set period that pricing must remain elevated or depressed for before affecting a rate change.
- The Board may also wish to impose a cap on the number of rate changes that may occur within a fiscal year or establish review periods within a fiscal year.

As reported previously by the Treasurer-Tax Collector (TTC), retroactive rate changes present significant challenges to staff. Making tax rate changes going forward, rather than making them retroactive, lessens the possibility of error. The TTC recommends that tax rate changes are done no

more than once per quarter. Multiple rate changes in a single quarter, along with the potential for square footage modifications, presents challenges in ensuring the tax system applies the correct rate to the correct period of time specified.

Considering the protracted market downturn and that operators continue to struggle with resolving their existing tax delinquency and meeting local requirements, staff recommends that rates only be subject to one change prior to the start of each fiscal year for the time being until the industry and market stabilizes. This would facilitate business planning on behalf of the cultivator and reduce the staff time required to effectively assess cannabis business taxes.

CONCLUSION:

The Program presented this item at the November 29, 2022, Cannabis Committee Special Meeting, however the Committee did not make a recommendation. Staff recommends approval of the proposed cost recovery rates:

- Indoor \$1.85 per square foot.
- Mixed-light \$1.27 per square foot.
- Outdoor \$0.62 per square foot.
- Nursery \$0.62 per square foot.

Staff recommends these rates be adopted for the remainder of FY 22-23 and through FY 23-24, with a review in January 2024 to consider pricing and cultivation tax rates prior to FY 24-25. This timeframe will provide additional relief to cultivators and will also allow ample time for County Counsel to review and ensure that there are no legal issues with the sliding scale concept. If the proposed rate reductions are approved, total Program costs will be reduced by \$1,579,689-or approximately 26% -down to a total of \$4,591,976. The impacts of such a reduction would result in the following disruptions to existing service levels:

- Reducing from three to two compliance inspection teams could complicate scheduling efforts and reduce the punctuality of site visits.
- Removal of the Accountant II position would further compound the workload of the CAO Finance Manager.
- Removing the CCA allocation would completely obscure visibility of Metrc information submitted by operators and there would not be a replacement data source to base the sliding scale upon.
  - If the DCC does not grant access to local jurisdictions by the spring of 2023, staff anticipates returning to the Board to restore this critical allocation.
- Public Health education efforts will be eliminated or there would be minimal outreach, and existing contracts with partner agencies could not be fulfilled.

Because the work will be distributed amongst the remaining allocations service levels will be impacted. Staff anticipates that turnaround times may increase particularly for compliance inspections.

The Program will implement the formal payment plan, but considering the complexity and timing, staff recommends the following revisions:

- Reduce the required down payment from 25% to 15%.

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- Delay due date to on or before January 31, 2023.

OTHER AGENCY INVOLVEMENT:

The Treasurer-Tax Collector and Office of County Counsel reviewed and contributed to this report.

FINANCING:

The proposed commercial cannabis cultivation tax rates will reduce estimated cultivation tax revenue to \$4,591,976. Excluding non-cannabis resources, this will enable cost recovery of Program staff and non-staff costs. It should be noted that cultivators are allowed to modify canopy square footage up to two times per fiscal year or duration of the annual permit and these modifications could potentially reduce cultivation tax revenue below Program costs.

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

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Attachments:

- A. Recap of Cannabis Cultivation Tax Rates
- B. Proposed Sliding Scale Cultivation Tax Rates