



County of Monterey

Item No.6

Board Report

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

Legistar File Number: 24-236

March 27, 2024

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- a. Receive a status update on the County cannabis business tax revenue generated by nursery activities;
- b. Consider the financial impacts of a tax exemption for self-producing nursery operators; and
- c. Recommend the Committee take no action on a tax exemption for self-producing nursery operators at this time; and
- d. Provide further direction as appropriate or consider a recommendation to the Board of Supervisors.

RECOMMENDATIONS:

It is recommended that the Board of Supervisors Cannabis Committee:

- a. Receive a status update on the County cannabis business tax revenue generated by nursery activities;
- b. Consider the financial impacts of a tax exemption for self-producing nursery operators; and
- c. Recommend the Committee take no action on a tax exemption for self-producing nursery operators at this time; and
- d. Provide further direction as appropriate or consider a recommendation to the Board of Supervisors.

DISCUSSION:

At the Board of Supervisors Cannabis Committee (Committee) meeting on January 4, 2024, a local operator requested that an item come before the Committee to consider an exemption from nursery taxes. This proposed exemption would only apply to operators who produce immature plants exclusively for their own cultivation rather than selling to third parties. Staff were directed to return with a report on this concept to the Committee.

This report provides: a retrospective of the cannabis business tax generated by nursery activities, a distinction between nursery operators producing for internal or external use, and the financial impacts of a tax exemption for self-producing nursery operators.

DISCUSSION:

Origin and history of the cannabis business tax imposed on nursery activities.

Voter approval of Measure Y in 2016 was the foundational act that enabled the creation of the County of Monterey Cannabis Program (Program). The ballot measure language read as follows:

“Shall the ordinance imposing a tax on commercial marijuana businesses in the unincorporated area of Monterey County only (not cities) up to a maximum of: \$25 per square foot on cultivation with an

annual adjustment by Consumer Price Index (CPI) thereafter; \$5 per square foot on nurseries with annual CPI adjustment thereafter; and 10% of gross receipts on other marijuana business activities with no CPI, potentially generating millions of dollars annually to help fund County services, be adopted?”

In January 2017, Ordinance Number 5274 added Chapter 7.100 to the Monterey County Code (MCC) to impose a general tax on commercial cannabis businesses in the County. This ordinance established an initial nursery tax rate of \$2.00 per square foot of authorized canopy (sq. ft.). Automatic increases of \$1.50 sq. ft. were set to occur at the start of July 2020 and 2021 to bring the tax rate to the voter approved maximum of \$5.00 sq. ft., followed by annual CPI adjustments.

In response to a combination of the COVID-19 economic downturn and the Hop Latent Viroid, Ordinances 5330 and 5349 were adopted to suspend the automatic increases that were set to take place in July 2020 and 2021. In March 2022, Ordinance 5371 removed automatic increases to alleviate a market correction in the commercial cannabis industry. Lastly, Ordinance 5396, adopted in February 2023, reduced the tax rate to \$0.71 sq. ft., which is the current rate for nursery activities.

MCC 7.100.040(W) defines “nursery” as:

“a person that produces only clones, immature plants, seeds, and other agricultural products used specifically for the planting, propagation, and cultivation of cannabis.”

Based on this definition, the Treasurer-Tax Collector informed the industry that they must hold a Department of Cannabis Control (DCC) nursery license to be taxed at the nursery rate. Those without a DCC nursery license would instead be taxed based on sq. ft. of their nursery at a rate tied to the type of cultivation occurring on site: outdoor, mixed-light, or indoor. For reference, DCC nursery licenses do not have an associated licensed canopy maximum in the way that DCC cultivation licenses do.

The cannabis business tax revenue generated by nursery activities is significant. Below are the collections by Fiscal Year (FY). Please note that the override code to separate collections by commercial cannabis activity was not established until FY 19-20.

- FY 19-20 \$832,233
- FY 20-21 \$1,264,085
- FY 21-22 \$857,045
- FY 22-23 \$740,195
- FY 23-24, Q1-Q2 \$745,132

It should also be noted that the proportion of revenue generated by nursery activities has increased over time, beginning at 5% of overall revenue in FY 19-20 and increasing to 21% of overall revenue in FY 22-23. Staff analyzed historical canopy registration figures and found that the proportion of nursery canopy has also increased over time, beginning at 26% of overall canopy in FY 19-20 and increasing to 39% of overall canopy in FY 23-24 to date.

Staff believes this trend is in response to broader pressure within the commercial cannabis market and the reduction to local nursery tax rates; there was a notable uptick in nursery canopy in early 2023 when the \$0.71 sq. ft. rate became effective. Staff estimates that pivoting cultivation to nursery would achieve the goals of lowering production costs and the risks associated with bringing a mature plant to a market that continues to see depressed demand. Staff would need to further confer with industry operators to confirm their understanding of the business strategy behind this shift.

Overview of nursery operators.

There are 32 operators who currently hold a DCC nursery license. Of these 32, 20 also hold one or more DCC cultivation licenses. Through the analysis of Metrc transfer data, staff have confirmed that 3 operators are exclusively transferring immature plants from their nursery to cultivation licenses within the current FY. Staff believes that these 3 would be considered within the scope of the exemption proposed to the Cannabis Committee in January 2024.

In FY 22-23, 7.8m immature plants were transferred to local cultivation licenses. Approximately 816k, or 10%, were transferred from the licenses of 2 self-producing nursery operators. In FY 23-24 to date, 5,025,698 immature plants were transferred to local cultivation licenses. 753k, or 15%, were transferred from the licenses of 3 self-producing nursery operators.

Financial impacts of a tax exemption for self-producing nurseries.

Staff estimates that the 3 operators that have been identified as self-producing nursery operators will generate approximately \$100k of nursery tax revenue in FY 23-24. Should the Committee direct staff to proceed with this concept, some or all this revenue could be lost depending on retroactivity and the entire amount would be lost in subsequent fiscal years.

It should also be noted that significant staff time would be required to analyze Metrc data to verify that these operators remain self-producing and/or qualify other operators who seek this exemption. Alternatively, staff could develop an attestation form that would retroactively trigger taxes, fees, and penalties if it was later discovered that the operator was not conducting self-producing nursery activities.

CONCLUSION

Although the cannabis industry continues to stabilize, staff does not believe the equilibrium between supply and demand has been reached. After factoring the limited number of qualifying operators, ordinance work required to implement, further reductions to cannabis business tax revenue, and Metrc analysis required to verify, staff recommends that the Committee take no action on a tax exemption for self-producing nursery operators at this time.

OTHER AGENCY INVOLVEMENT:

The Cannabis Program prepared this report with input from the County Administrative Office and the Office of the County Counsel.

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FINANCING:

Monterey County's Cannabis Program is funded in County Administrative Office - Department 1050, Intergovernmental and Legislative Affairs Division - Unit 8533, Cannabis. If an amendment to Chapter 7.100 created a tax exemption for self-producing nursery operators, staff estimates that cannabis business tax revenue would be impacted by a loss of approximately \$100,000 on a fiscal year basis.

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, Interim Cannabis Program Manager x 3084

A blue ink signature of Joann Iwamoto, consisting of a stylized 'J' and 'I' inside a rounded rectangular box with 'DS' in the top right corner.

Approved by: Nicholas E. Chiulos, Chief Assistant County Administrative Officer x 5145