



# Monterey County

**Item No.**

## Board Report

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

**Legistar File Number: 21-1071**

**December 14, 2021**

**Introduced:** 12/3/2021

**Current Status:** Agenda Ready

**Version:** 1

**Matter Type:** General Agenda Item

- a. Consider options to amend the commercial cannabis tax structure, rates, and penalties and interest for delinquent tax accounts; and
- b. Consider directing the Cannabis Program to amend Monterey County Code Chapter 7.100; and
- c. Provide further direction as appropriate.

### RECOMMENDATIONS:

It is recommended that the Board of Supervisors:

- a. Consider options to amend the commercial cannabis tax structure, rates, and penalties and interest for delinquent tax accounts; and
- b. Consider directing the Cannabis Program to amend Monterey County Code Chapter 7.100; and
- c. Provide further direction as appropriate.

### SUMMARY:

For several months the Cannabis Program (Program) has scheduled monthly meetings with the local cannabis industry (Industry) to discuss relevant topics and concerns. The Industry voiced concerns over the commercial cannabis cultivation and distribution tax rates imposed by Monterey County Code (MCC) section 7.100.050. Specific to the distribution tax, MCC Chapter 7.100.050(G), the Industry's concern was that this tax places operators within Monterey County at a competitive disadvantage when compared to other jurisdictions that do not impose a distribution tax. The Industry has also expressed concerns that commercial cannabis product is taxed at each stage of the supply chain in Monterey County. The Program presented information related to the distribution tax to the Cannabis Committee (Committee) and Budget Committee in July and August 2021 respectively.

With regard to the commercial cannabis cultivation tax rates, the decline in cannabis wholesale price points has severely impacted the Industry financially. The Industry requested that a subcommittee be formed to discuss the current downward trends in wholesale price points and the commercial cannabis tax structure and rate, as set forth in Monterey County Code Chapter 7.100.50. Through these subcommittee meetings, the Program has provided updates to the Committee on November 17th and November 29th of 2021. (Attachment A) The Committee directed staff to present these updates to the Board of Supervisors (Board) with options for consideration. The Budget Committee Chair also approved that this matter be presented directly to the Board.

### The options for the Board to consider are as follows:

1. Reduce the distribution tax rate from 3% to 1%.
2. A \$4/\$7/\$1.50 model represents \$4 for mixed-light, \$7 for indoor, and \$1.50 for outdoor. This

- represents a 17% decrease in cannabis revenue for the current fiscal year (FY).
3. A \$3/\$6/\$1 model would represent a 25% decrease in cannabis revenue for the current FY.
  4. Eliminate the cannabis tax escalator.
  5. Place a stay on delinquent commercial cannabis tax account penalties and fines on unpaid installments of the annual commercial cannabis business tax until June 30, 2022.

Based on the direction provided to the Program, staff could prepare and have an ordinance amending MCC Chapter 7.100 ready for Board consideration in January 2022. The ordinance will require two readings before the Board. The ordinance can be written so that any changes are made retroactive to January 1, 2022.

#### DISCUSSION:

##### Distribution Tax.

Monterey County imposes an annual gross receipt on commercial cannabis distribution activities. The distribution tax rate is currently set at 3% of gross receipts. It is important to note that when the distribution tax was set by the County, vertical integration was not allowed under state law. State law has since been changed and vertical integration is allowed. Distribution is typically structured as either a wholesaler or provider of a service to transfer commercial cannabis products from one licensee to another. Licensed distributors may also provide the following services: packaging, re-packaging, labeling, relabeling, and storage.

Vertical integration is when a business has control of multiple points of the supply chain. This may manifest itself through a merger or acquisition of separate businesses with distinct stages of production into one business, or it can exist in the initial structure of a business. An example of this in the cannabis industry would be an operator who has a cultivation license, a distribution license, and a retail license. Local operators meet the definition of vertical integration when they are interrelated through their corporate structure. Individuals who have ownership interests in multiple operations are not vertically integrated unless their corporate structure is demonstrably interrelated via documentation provided to the Secretary of State of California. It is important to note, operators who meet the definition may deduct the cash value of transactions from gross receipts as outlined in section 7.100.040(Q).

The concern expressed to the Program by the Industry is that distributors typically follow one of two business models:

- Buy in bulk, using purchasing power to drive per unit costs down and sell at market rates to create margins.
- Take possession of product and sell for a service fee/pre-negotiated price.

Both business models encounter the same problem: when the business is taxed on gross receipts, the cost of goods is not always considered. This means that distributors must be profitable on very small margins or they will be vulnerable to undercutting by distributors in other jurisdictions who do not impose distribution taxes.

As presented by the Treasurer-Tax Collector (TTC) staff in March 2021, less than half of distributors registered with TTC reported gross receipts or paid distribution taxes in the prior two FYs. As a point

of reference, 40 distributors were registered in FY 18-19 and 46 were registered in FY 19-20. In FY 19-20, distribution tax revenue totaled \$839,039. Operators were required to provide their METRC API key to the TTC by July 15, 2020 to enable the TTC to monitor transactions through the California Cannabis Authority (CCA) and confirm reported gross receipts. Following submission of the METRC API key to the CCA, the TTC observed an increase in distribution tax revenue reported. In FY 20-21, distribution tax revenue totaled \$1,230,240.

In July 2021, the Committee directed the Program to the Budget Committee with a recommendation to reduce the commercial cannabis distribution tax rate to 0% of gross receipts for a period of three years, with the capability to amend in the future. The Budget Committee received the report and directed staff to the Board with a recommendation for an additional option to reduce the rate to 1% of gross receipts, to take effect either halfway through FY 21-22, or at the beginning of FY 22-23.

#### Commercial Cannabis Tax Structure, Rates, Delinquent Penalties, and Interest.

A subcommittee was formed to further discuss the commercial cannabis tax structure and rate. The Committee received a memorandum on the subcommittee meetings on November 17th and 29th of 2021. The following is a summary of the Industry's request:

1. Immediate reduction in commercial cannabis cultivation tax rates.
  - a. The Industry proposes an indefinite reduction to commercial cannabis cultivation tax rates that match the "3/2/1 taxing model" implemented by the Counties of Humboldt and Lake. This implies \$3/square foot (sf) for indoor cultivation, \$2/sf for mixed-light cultivation, and \$1/sf for outdoor cultivation. This proposed change would result in a 60% reduction from current cultivation tax rates of \$8/sf for indoor, \$5/sf for mixed-light and \$2.50/sf for outdoor. As of this writing, there are no licensed outdoor grow cultivators in Monterey County. The 3/2/1 taxing model was intended to be a starting point for conversation.
2. Remove the commercial cannabis automatic annual tax escalator.
  - a. The Industry requests removal of the automatic annual tax escalator. The suspensions of the escalator have occurred in subsequent FYs. The FY 20-21 suspension was in response to the COVID-19 pandemic. The FY 21-22 suspension was also in response to the COVID-19 pandemic, in addition to a local outbreak of the Hop Latent Viroid in April 2021.
    - i. The operative word with this viroid is "latent," meaning that it was largely asymptomatic and not evident until later stages of cultivation where the harvest yields and potency of Tetrahydrocannabinol, the psychoactive component generated by cannabis plants, were both greatly impacted. Operators reported lower prices through the affected period, but there is not a clear indication of this within the wholesale pricing information. (Attachment A, page 27)
3. Consider placing a stay on the penalties and interest for tax payments deemed delinquent.
  - a. MCC section 7.100.080 specifies when tax payments are delinquent. MCC section 7.100.100 specifies the penalties and interest due for such delinquency. The industry requests a stay on these penalties and interest for the current FY, which ends on June 30, 2022.
4. Miscellaneous comments and suggestions to assist the Industry during this period of declining wholesale price points for commercial cannabis.

- a. Overhead costs are increasing industrywide.
- b. Cost of goods sold, the direct costs of producing commercial cannabis products including materials and labor, is increasing, partially due to shortages in the supply chain.
- c. Decline in the cannabis industry workforce due to layoffs.
- d. Finished goods are being sold at a much lower price point.
- e. Industry businesses are carrying accounts receivables for longer periods of time and are challenged to collect, further impacting cash flow.
- f. The Committee should consider reviewing the Program and reducing staffing levels as the business entities become fully permitted and require less County monitoring.

#### Program Research and Analysis

The Program conducted interviews with the California Cannabis Authority (CCA) and the County Administrative Office Budget Director. Here is the analysis to date:

1. Decline in commercial cannabis wholesale price point and the inability to identify when a correction may take place.
  - a. The Program has been monitoring the significant decline in the wholesale price point since April 2021. Like traditional agriculture, Monterey County cannabis price points tend to be higher than other counties because the cannabis is cultivated in a desirable geographic growing region. Another indication of a higher price point could be the inconsistency of the permittee to update consignment pricing in Metrc; the Program is working with CCA and industry operators to establish best practices for reporting consignment prices. CCA met with the subcommittee members and County staff on December 1, 2021 to begin such discussions.
  - b. Relative to October 2020, average wholesale prices are down \$683 per pound, which represents a 56% decline. (See Attachment A, page 27) It would be difficult to forecast if or when a correction could occur, but analysts, including CCA, project a change or correction in the spring of 2022. The Industry speculates that the change or correction may not occur for some time.
2. Increase in inventory levels among permittees in Monterey.
  - a. Compared to 2020, permittee inventory levels have increased due to the decline in wholesale price points and the “waiting game” of determining the optimal time to sell. The higher level of inventory is indicative of reduced gross sales, which impacts cash flow and could lead to delays of infrastructure improvements and employee layoffs. In July 2021, the Program required industry operators to submit employee rosters. At that time, the industry employee workforce equaled approximately 2,400. The Program could request current employee information to update the workforce count if the Board desired.
3. Preliminary discussion with the CAO Budget Director on financial impacts for the current FY.
  - a. On November 18th and 29th of 2021, the Program met with the CAO Budget Director to review financial impacts to the current FY budget if the Board approved a policy decision to amend the commercial cannabis tax rates. If rates were decreased, there would be a financial impact to the current budget, reducing department services. Impacts would be dependent on the scale of tax reductions.
  - b. Based on the proposed amended commercial cannabis tax rates, there could be an

- estimated \$5.2m decrease in the current FY of cannabis tax revenue and an estimated \$8.8m decrease in FY 22-23 compared to the cannabis revenue estimates provided on July 1, 2021.
- c. The Cannabis Assignment balance as of December 1, 2021 is \$18,693,631.
  - d. The CAO Budget Office requested proposed costs for FY 22-23 from the Program on November 15, 2021. The current FY 21-22 Program costs are \$6,334,421.18. The proposed FY 22-23 Program costs are estimated at \$6,346,485.85, but this does not include all salary increases, as some bargaining units are still in negotiations.
4. CCA Insights.
- a. The CCA has developed “The NCS Transparency Project,” which automatically updates each month on the Program’s webpage. The Project is a publicly available data portal, specific to Monterey County, filled with industry insights and useful information geared towards the average citizen. The Program uses the NCS Platform’s data points for a multitude of regulatory and compliance needs, including tracking the wholesale and retail price points. It should be noted that the data available within the NCS Platform is complex and will require collaborative discussions to interpret, refine, and reflect upon when factoring into policy decisions. These discussions should include industry operators.
  - b. Indoor prices are typically higher, and they are impacted less because the product is viewed as higher quality and therefore commands a higher price point than outdoor or mixed-light cultivation.
  - c. A canopy-based tax structure is much easier to implement and regulate, but it impacts growers differently. Smaller growers typically amortize their tax liability across fewer harvests; relative to a large grower with greater economies of scale, amortization is more burdensome to a small grower. When the costs of goods sold shift, this method becomes disproportionate. A gross receipts tax is difficult to regulate, but when reliably reported, tax revenues and industry revenues are correlated.
  - d. Due to varied opinions on the accuracy of CCA data, the Program scheduled an initial meeting with CCA on December 1, 2022 with industry operators and representatives to share information, ask questions, and gain knowledge for understanding. This will be an on-going effort as we continue our collaboration with the Industry and partners.
5. Cannabis Program Forum (Forum).
- a. On November 19, 2021, Monterey County hosted the Forum, which consists of thirteen counties as far north as Nevada County and south to Santa Barbara County. The Forum meets quarterly to discuss a variety of topics and to share information. At the recent Forum, the Program asked about cannabis tax rates and collection and received the following input:
    - i. A recent Department of Cannabis Control (DCC) weekly listserve identifies 7,085 active cultivation licenses in the state. (Attachment A, page 28) The table within the attachment breaks down both state licenses and how commercial cannabis is taxed. It has been filtered to the top 12 counties in terms of cultivation licenses, with total license counts reflected in the grand total.
    - ii. Richard Parrott, DCC Deputy Director of Compliance, was the guest speaker at the Forum. Mr. Parrott discussed topics related to DCC consolidation efforts, including refinements to compliance and enforcement mechanisms, better

collaboration with local jurisdictions, and the development of compliance training and education programs. Mr. Parrott emphasized that DCC's goal is to build and sustain a strong compliance and enforcement structure.

- iii. Nevada County is considering moving from its current 2.5% of gross receipts model to a canopy tax following the 3/2/1 model. Its operators are considering transitioning to mixed-light because there is no demand for outdoor flower.
- iv. Santa Cruz County reported a 70% decline in their tax revenue relative to the prior FY, but the county has not seen an increase in tax delinquency. This is due in part to their gross receipts-based tax model, which correlates with the widespread decline in wholesale pricing; as sales decline, so do tax liabilities. Operators are reportedly following their fields because they are not profitable to harvest. Abnormally foggy weather led to moldy crops, further contributing to price declines. Santa Cruz County's Board has not requested a reduction to the 6% gross receipts commercial cannabis tax rate as of this writing and may be considering an ordinance to permit consumption lounges. The County Licensing Office has audited retail dispensaries for years and will begin audits of non-retails soon.
- v. San Luis Obispo County recently put a stay on an automatic increase that would have raised its gross receipt tax from 6 to 8%. This was in part because of reports of several operators following their fields. Licensed operators cite their heavy tax burden and more stable prices as incentives to divert into the unlicensed market.
- vi. Santa Barbara County reported current year tax collections are 40% below projections.
- vii. Sonoma County operators were affected by mold saw crop destruction. They are working on a request to their Board to freeze tax rates.
- viii. A few jurisdictions expressed interest in drafting a letter to address tax reform at the state level.

#### Commercial Cannabis Proposed Amended Tax Structure and Rates.

The Committee directed the Program to prepare proposed commercial cannabis tax rates. Attachment B outlines the following with these assumptions.

1. Cultivation square footage numbers were used as of November 30, 2021.
2. Distribution, manufacturing, and retail gross receipts are values used from FY 20-21.
3. Proposed commercial cannabis tax revenue is based on the amended ordinance to be retroactive to January 1, 2022.

#### Options for the Board to review and consider.

1. Reduce the distribution tax rate from 3% to 1%.
2. A \$4/\$7/\$1.50 model represents \$4 for mixed-light, \$7 for indoor, and \$1.50 for outdoor. This represents a 17% decrease in cannabis revenue for the current FY.
3. A \$3/\$6/\$1 model would represent a 25% decrease in cannabis revenue for the current FY.
4. Eliminate the cannabis tax escalator.
5. Place a stay on delinquent commercial cannabis tax account penalties and fines on unpaid installments of the annual commercial cannabis business tax until June 30, 2022.

Based on the direction provided to the Program, staff could prepare and have an ordinance amending MCC Chapter 7.100 ready for Board consideration in January 2022. The ordinance will require two readings before the Board. The ordinance can be written so that any changes are made retroactive to January 1, 2022.

Staff notes it is important to highlight the immediate turnaround of reports to the Committee and Board with the anticipated preparation of an amended ordinance that has and will take significant time to research and develop. TTC staff will be required to amend tax rates in a timely manner and determine if refunds are applicable which will impact their other work responsibilities. Program staff remain committed to meet the needs of the Industry, yet other work is currently being re-prioritized and may impact the local jurisdiction assistance and equity grants proposed awards.

OTHER AGENCY INVOLVEMENT:

The County Administrative Office Budget Director, Office of the County Counsel, and California Cannabis Authority were involved in the preparation of this report.

FINANCING:

Monterey County’s Cannabis Program is funded through County Administrative Office - Department 1050, Intergovernmental and Legislative Affairs Division - Unit 8054, Cannabis, and approval of this report will not incur additional expenses to the Program. However, based on the amended commercial cannabis tax rates, there could be an estimated \$5.2m decrease in the current FY of cannabis tax revenue and an estimated \$8.8m decrease in FY 22-23 compared to the cannabis revenue estimates provided on July 1, 2021. Every \$1m reduction in the cannabis tax would translate to approximately 0.5% reduction in discretionary revenue to provide services across all general fund departments.

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, Cannabis Program Manager  
Approved by: Nicholas E. Chiulos, Assistant CAO

DocuSigned by:  
*Joann Iwamoto* 12/6/2021 | 8:33 AM PST  
B759D9F5D66A4D7...  
[On behalf of Nicholas Chiulos]

Attachments:

- A. Cannabis Committee Reports on Wholesale Pricing (Legistar File Nos. 21-966 and 21-1053)
- B. Current and Proposed Cannabis Tax Rates

*Legistar File Number: 21-1071*

---