

# MONTEREY COUNTY

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## **Intergovernmental & Legislative Affairs** Monterey Cannabis Program

**Nicholas E. Chiulos**  
Assistant CAO

Date: May 2, 2018

To: Board of Supervisors Cannabis Committee

Fr: Joann Iwamoto, Cannabis Program Manager

Re: Commercial Cannabis Tax Rate

Attached are letters that were submitted for consideration regarding Agenda Item #1, Consider recommendation to the Board of Supervisors regarding Commercial Cannabis Tax Rate.



May 2, 2018

*Via Email*

Mr. Joann Iwamoto  
Cannabis Program Manager  
County of Monterey Administrative Office  
168 W. Alisal St., 3<sup>rd</sup> Floor  
Salinas, CA 93901

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E. Soren Diaz, Of Counsel  
Doug K. Dusenbury, Of Counsel

**RE: Cannabis Tax Rate and Standing Committee Special Meeting**

Dear Ms. Iwamoto,

On behalf of my clients, and cannabis industry partners, who are among the 900,000+ square feet of currently registered applicants ("Current Growers") for cannabis related permits in Monterey County, this is to provide you with our proposal for an amended and new applicable tax rate for the fiscal year starting July 1, 2018.

This proposal, in our opinion, will result in at least 2 million square feet of registered and permitted growers ("Anticipated Growth"), and will yield the County much more than the \$3.5 Million identified to run the cannabis program and it will result in additional funds available for the public in general. This proposal will net the County a minimum of \$4,275,000 for the next fiscal year.

**A. Our Proposal.**

We request that the County modify its cannabis tax ordinance for the 2018-2019 fiscal year ("Fiscal Year") as follows:

- For the first 6 months of the Fiscal Year, the first two quarterly payments shall be based on an annual tax rate of \$4.00 per square foot of cultivation (this would generate \$1,800,000 from Current Growers, and a total of \$4,000,000 when including Anticipated Growth, in the first 6 months of the year); and,
- If the Anticipated Growth registered or reported equals 2 million square feet of cultivation or more by December 31, 2018, then the tax rate for the year should remain at \$4.00 per square foot (this would generate a total of \$8,000,000 for the next Fiscal Year); however,
- If the Anticipated Growth does not exceed 2 million square feet of cultivation by December 31, 2018, then the applicable tax rate for the last two quarters of the Fiscal Year should be \$5.50 per square foot (this would generate an additional \$2,475,000 after using only the Current Growers' area (with no growth), for a total of \$4,275,000 for the Fiscal Year).

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The object of this proposal is to provide the County with a bottom line number (\$4,275,000) in the event no additional growth occurs next year even with a lower tax, which is extremely unlikely. At \$4.00 per square foot, my clients (I represent applicants who have capacity to utilize conservatively over 5 million square feet) have indicated to me that they will exceed the footprint reported in today's fiscal year, and I am confident that they will report 2 million square feet.

**B. Reasons for Proposal and Issues Since Initial Tax.**

In 2015, the cannabis industry supported the concept of a reasonable tax to accomplish two objectives: (1) establish and pay for the implementation of a cannabis program in the County of Monterey to accompany the new cannabis ordinance; and (2) provide a community benefit as a result of the new legal industry (by moving funds historically generated and remaining in a black market towards addressing addiction and providing the public with funding for other local issues).

Our objective, which we believe is aligned with the County's, is to assure that the County has more than adequate revenue to run the program to pay for (i) law enforcement (Sheriff and District Attorneys) to reduce or eliminate the impact of the black market, and (ii) planners and RMA personnel to administer the permits, check compliance, issue business permits, etc. Our other objective is to allow cultivators room in their budget to finance necessary infrastructure improvements and to invest in the long term future of the industry here.

There have been significant changes or errors in the assumptions leading to the \$15 per square foot. Those changes or errors in assumptions are summarized as follows::

1. State taxes were not included in initial review. The state now imposes a tax of \$148 per pound. According to HdL's current report, this new tax rate "leaves little room for local jurisdictions to work within if they wish to remain under the total cumulative tax rate of 30%. This is an important benchmark to allow the local industry to compete against the black market and against other regulated cannabis businesses from around the state."
2. The price per pound has dropped significantly and faster than anyone had anticipated. The report that HdL prepared for the County originally believed the price of cannabis would hold at an average of over \$1800 per pound. In a matter of 6 months last year, the price ended up between \$600 to \$800 per pound on average, less than half of the County consultant's initial projection. The impact of this is it more than doubles the impact of the \$15/sq ft tax (the impact is essentially \$30/sq ft).
3. PG&E will not upgrade necessary infrastructure. The original HdL report based the \$15/sq ft tax on the ability of the industry to harvest at least 5 times per year. Without power upgrades, the industry is forced to use very little supplemental lighting in the winter, which results in an average number of harvests between 2 harvest during the summer and fall

months, and a half-yielding harvest in the winter/spring months. The impact of this is to double the cost of the tax, because one half of the yield is available to sell (and when added to the impact of the price per pound dropping, the effective tax rate is up to \$60/sq ft.).

4. Existing infrastructure has been inadequate and requires major capital expenditures to fight humidity. The available greenhouse space is located north of Chualar, where in the summer months the fog is prevalent, which leads to problems with humidity and mold. There is not one greenhouse that has been ready, turnkey, to walk into and begin cultivation. Every square foot in Monterey County requires some type of retrofitting, and most of it is very expensive (HVAC systems to control/dehumidify air as it enters the greenhouse is an example, as well as building walls and separating growing rooms to assure more control over a smaller area). Also, important to note, is that the state has issued regulations that require growers to comply with pharmaceutical grade testing for microbial and pathogens. We support that standard, but it has been at significant expense.
5. Permit reports, processing and the application process in general has been longer than anticipated. A typical application takes 6-12 months for simple remodeling and building permits in some cases. Many of my clients in the CUP process have taken over a year to get to hearing. We acknowledge that it is due to the fact that all applicants are applying at same time, but it has had an unforeseen impact on ability to finance operations at more favorable rates (which get better with permits in hand).
6. The Monterey County Regional Fire District Tax is likely to pass, adding \$0.18 per square foot of tax on the Current Growers. In addition to the State taxes, we are very concerned about the cumulative effects of these taxes on the industry. We support the fire tax, but ask that you please consider this in determining that \$4.00 per square foot of County tax is prudent.
7. The black market has getting bigger and bolder with no enforcement. We understand that the County is working on solutions to this. However, the black market is a large reason the price per pound has dropped significantly, and when they do not have to pay any tax, are not held to labor standards that those in the legal market are held to, and sell to any state in the nation, it creates a burden and punishes those that are engaged in this program the right way.
8. This is not to mention license and application fees at all levels of approvals.

Finally, in order for us to focus on middle income paying technical jobs supporting the industry, we ask that you tax manufacturing, testing, and distribution between 0-1%. We have argued for years to try to provide incentives to bring the value added product of grapes (bottles of wine) to

Ms. Joann Iwamoto  
County of Monterey, Cannabis Program Manager  
2 May 2018  
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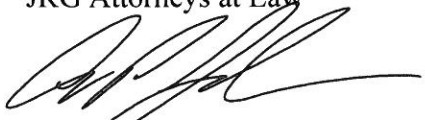
establish themselves here. We need these supporting industries and the tax generated is minimal compared to cultivation.

In summary, we support a \$4.00 tax, which we believe will provide incentives for new cultivators to voluntarily participate in the legal system, and will significantly reduce or eliminate the effect of black market on our local cultivators.

Please let me know if you have any further questions or comments on this issue.

Very truly yours,

JRG Attorneys at Law

A handwritten signature in black ink, appearing to read 'A. P. Johnson', with a long horizontal flourish extending to the right.

Aaron P. Johnson

APJ:jj



## MCCIA

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Joann Iwamoto  
County of Monterey  
168 West Alisal Street, 3rd Floor  
Salinas, California 93901

### RE: Cannabis Tax Rate

Dear Ms. Iwamoto,

On behalf of the Monterey County Cannabis Industry Association (MCCIA), we are writing today to request that the County modify its cannabis tax ordinance for the 2018-2019 Fiscal Year. We appreciate the opportunity to provide input on the taxation structure for the Monterey County cannabis program, and look forward to working together to find a solution that works for the industry, the County and the community at large.

It is our recommendation that for the first 6 months of the Fiscal Year, the first two quarterly payments shall be based on an annual tax rate of \$4.00 per square foot of cultivation. If the anticipated growth registered equals 2 million square feet of cultivation or more by December 31, 2018, then the tax rate for the year should remain at \$4.00 per square foot, however, if the anticipated growth does not exceed 2 million square feet of cultivation by December 31, 2018, then the applicable tax rate for the last two quarters of the Fiscal Year should be \$5.50 per square foot. We believe that this modification will help allow more square footage of permitted grow to be developed, resulting in an overall greater tax yield for the County and its residents.

There have been significant changes or errors in the assumptions leading to the \$15 per square foot tax originally estimated. These include;

- State taxes were not included in initial review. The state now imposes a tax of \$148 per pound. According to HdL's current report, this new tax rate "leaves little room for local jurisdictions to work within if they wish to remain under the total cumulative tax rate of 30%. This is an important benchmark to allow the local industry to compete against the black market and against other regulated cannabis businesses from around the state."

- The price per pound has dropped significantly and faster than anyone had anticipated. The report that HdL prepared for the County originally believed the price of cannabis would hold at an average of over \$1800 per pound. In a matter of 6 months last year, the price ended up between \$600 to \$800 per pound on average, less than half of the County consultant's initial projection. The impact of this is it more than doubles the impact of the \$15/sq ft tax (the impact is essentially \$30/sq ft).

- Existing infrastructure has been inadequate and requires major capital expenditures. Every square foot in Monterey County requires some type of retrofitting, and most of it is very expensive. Also, important to note, is that the state has issued regulations that require growers to comply with pharmaceutical grade testing for microbial and pathogens. We support that standard, but it has been

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at significant expense.

- The Monterey County Regional Fire District tax on the June, 2018 ballot is likely to pass, adding \$0.18 per square foot of tax on current operators. This should be included in the cumulative effects of these taxes on the industry.
- The black market has getting bigger and bolder with no enforcement. We understand that the County is working on solutions to this. However, the black market is a large reason the price per pound has dropped significantly, and when they do not have to pay any tax, are not held to labor standards that those in the legal market are held to, and sell to any state in the nation, it creates a burden and punishes those that are engaged in this program the right way.

We look forward to working together to find a solution that supports the legal industry, significantly reduces or eliminates the effects of the black market operators and that will ultimately result in a greater tax benefit for our residents.

Sincerely,  
The MCCIA Board of Directors

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