

# MONTEREY COUNTY

## COUNTY ADMINISTRATIVE OFFICE

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**TO:** Board of Supervisors Cannabis Committee  
**FROM:** Nick Chiulos, ACAO; Joann Iwamoto, Cannabis Program Manager  
**DATE:** May 2, 2018  
**SUBJECT:** Commercial Cannabis Tax Rate

### **Recommendation:**

Staff recommends that the Board of Supervisors Cannabis Committee consider and recommend to the Board of Supervisors the following ordinance amendments:

- 1) Amend the cannabis tax rate structure as outlined in Attachment "A".
- 2) Amend the tax penalty provisions for late tax payments. Currently the penalty is set at 25% of the amount of tax due, plus interest the first month the tax is outstanding. After one month, an additional 25% penalty plus interest is imposed. Staff recommends reducing the penalty to 10% of the amount of outstanding tax due, plus interest for the first month. After one month, an additional 10% plus interest.
- 3) Amend the definition of "canopy" to be consistent with the State's definition. This amendment will mean that cultivators will only be taxed on the square footage of mature plants in their operation.

### **Background:**

In 2015/2016, the Board of Supervisors was actively considering the possibility of permitting medical and, if approved by voters of California, commercial cannabis cultivation, manufacture, distribution and dispensing. The Board made the decision that it was willing to take this step if the voters approved a general tax measure to tax the commercial cannabis industry to provide revenue for general governmental purposes, including the cost (undetermined at that time) of administering the program. The potential tax structure and revenue estimates were prepared by HdL Companies, and projected the potential for double digit revenue to the County. The voters approved the tax and, subsequently, the Board adopted ordinances to establish a permit process and set the tax rate. The tax rate for cultivation was set at \$15/square foot of canopy.

Cultivation was restricted to existing greenhouses in the "Farmland" zoning district. The principal source of concern at this time from the industry is the cultivation tax rate. The industry feels that the rate of \$15/sq. ft. is too high, especially given the fact that the State imposed a tax on cannabis after Monterey County voters approved Measure "Y". The industry feels that the cumulative effect of State and local taxes is excessive, and is seeking relief from the County in the form of a tax rate reduction.

HdL Companies has been retained to prepare a revised Fiscal Analysis and to recommend potential tax rates for consideration. David McPherson of HdL Companies presented this analysis to the Committee at an April 6, 2018 Special Meeting. Regarding cultivation tax rates, HdL believes the County should consider a rate of between \$4/sq. ft. and \$7/sq. ft. HdL believes that this range of tax rates is consistent with cultivation tax rates under consideration by variety of California jurisdictions. HdL cites the cumulative tax rate (State & Local), market competition, price reduction and black market activities as reasons to lower the tax rate. Staff concurs that the tax rate does need to be adjusted to some degree and has carefully reviewed a number of issues and factors to consider which have led to our recommendation. Ultimately, the tax rate is a policy decision of the Board of Supervisors which has complete discretion to lower the tax rate to the level it feels appropriate and justified.

### **Issues/Factors to Consider:**

Staff believes that it is important for the County to take reasonable measures to facilitate the success of the local cannabis industry. The industry generates tax revenue, creates local jobs and leads to the re-use/revitalization of greenhouses vacated after the departure of the cut flower industry. Staff also believes, however, that the cannabis tax rate cannot be viewed solely in the light of what will benefit the industry and that there are a number of factors which should be considered in determining a revised tax rate.

#### ***1) Cost to administer the program.***

The County cannabis program is complex, labor intensive and involves 10 County departments in administration, permitting, tax collection, enforcement, public/industry outreach, and public health. Staff has worked extensively to calculate the realistic cost to administer the program in FY18-19. The cost was reviewed by the Committee in March 2018. On April 24, 2018, the Board of Supervisors reviewed and preliminarily approved a program cost of \$3.2 M for FY18-19, while recognizing that a final decision would not occur until the budget hearings in June 2018. This dollar amount represents the minimum program cost which must be funded in FY18-19 unless the Board chooses to further adjust program cost. A significant cost component will be enforcement against illegal and black market operators. This enforcement priority has been strongly voiced by the industry.

#### ***2) County budget deficit for FY18-19 and subsequent years.***

The County is facing a significantly constrained budget for FY18-19 and the foreseeable future. Simply put, expenses for critical public services have outpaced revenues. The FY18-19 deficit is projected to be approximately \$36M. Balancing the budget and protecting critical County services is expected to result in dramatic reductions in other County services, as well as elimination of many filled and vacant positions in the County workforce. All sources of discretionary revenue will be absolutely critical to help address the County's budget deficit. A conservative reduction in cannabis tax rates recommended by staff will assist the industry while also preserving critical discretionary revenue to fund other County priorities. A series of charts are attached to this memo as Attachment "B" which depict the amount of expected revenue over and above program operation costs that would be available for the Board to allocate for other needed County

programs and services. These charts show revenue generated from the four cultivation tax rate alternatives analyzed by staff: \$15/sq. ft., \$10/sq. ft./\$7/sq. ft. and \$4/sq. ft.

**3) *Needs Identified in the Community Engagement Process.***

Recently, at the direction of the Board of Supervisors, staff conducted an extensive community engagement process to obtain input from the public regarding how cannabis tax revenue should be spent over and above program operating costs. A significant amount of public input determined that early childhood education and health/behavioral health were critical areas that the public felt should be funded with cannabis general tax revenue. The level of adjustment in the cannabis tax rate will determine the amount of revenue available to help fund such programs, should the Board desire to do so.

**4) *Benefits of Monterey County to Cannabis Industry.***

Although market competition in the California cannabis industry is strong, there are significant benefits to locating and operating in Monterey County including:

- a) Centrally located in the state;
- b) Available and skilled agricultural workforce;
- c) Well-developed transportation network; and
- d) “Greenhouse focused” County regulatory structure significantly benefits those who chose to invest in greenhouses for cannabis cultivation.

**5) Legislation to lower State tax rate.**

Legislation has been introduced to lower the State of California tax rate. The County of Monterey has gone on record to support this legislation which, if passed, will provide significant relief to the industry. The cost of administering and enforcing the cannabis program falls predominantly on local governments. Staff believes that it is appropriate for the State tax to be lowered. County taxes should be retained at a reasonable level to address the “on the ground” cost of program administration, enforcement, and to address the collateral impacts of legalized cannabis use in our County.

**6) Impact on Monterey County cities.**

City managers in Monterey County cities that permit cannabis are closely monitoring the tax rate discussion at the County level and are concerned about how lower County tax rates may impact their jurisdiction. It is highly likely that whatever tax rate is ultimately established by the Board, pressure will follow to change tax rates in the cities which will in turn impact city budgets and ability to fund critical programs within their jurisdictions cannabis tax rates and revenue. Comparative tax rates within Monterey County cities which permit cannabis are show in Attachment “C”.

**7) Industry input.**

Staff has recently met with representatives of the local cannabis industry who propose a significant reduction in taxes to incentivize the industry with an increase in taxes if certain square footage targets are not met. While staff appreciates the industry proposal conceptually, we have concerns with the proposal, including:

- a) Difficult to draft as an ordinance.
- b) Difficult to administer and validate.
- c) Could fund basic program operation costs, but reduces revenue available to fund other critical County budget needs.

**8) Timing.**

The next year is expected to be one of transition in the cannabis industry. In January 2019, the State will stop issuing temporary licenses. All cannabis operators must obtain County permits and business licenses by this time in order to operate legally. Some staff feels that the cannabis industry should operate for a longer period of time before the County considers any tax rate adjustment.

In addition, at the present time tax collection is largely based on self reporting while cannabis operations are in the County's permitting process. There is a significant lack of independently verifiable data about the local cannabis industry. Staff expects this to begin to be addressed in the coming fiscal year due to State licensing requirements as well as the County's participation in the California Cannabis Authority. This is the JPA which will create and maintain a comprehensive data base on industry activities.

Staff believes that some tax rate adjustment is appropriate, but should be approached carefully and conservatively.

**9) Schedule**

Going forward, staff intends to report the Committee recommendation to the Board of Supervisors at its May 22, 2018 meeting. Should the Board direct changes to the tax rate, staff will draft and present ordinance amendments to the Board in July 2018 to be retroactive to July 1, 2018.

**Summary:**

Staff has reviewed and carefully considered a number of potential cultivation tax rate scenarios (Attachment "B") as well as issues and factors which should inform the consideration of cannabis tax rate changes generally. The staff recommendation shown on Attachment "A", along with contemplated changes in the tax penalty provisions and canopy definition are expected to provide a level of relief to the industry, while preserving a vital revenue source which is critical to cannabis program operation and to help mitigate the County's fiscal stress in FY18-19 and subsequent years.