Legislation Details (With Board Report)

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Type:	General Agenda Item	**Status:**	Passed
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Title: a. Receive a staff report for implementation of a payment plan option for commercial cannabis cultivation tax to address Fiscal Year 21-22 delinquent payments and additional options to retroactively reduce the tax rates to provide the industry with a fresh start in Fiscal Year 22-23; and
b. Consider other issues bearing on the Board’s decision on tax rates related to the commercial cannabis industry, including its data reporting practices; and
c. Support the creation of a commercial cannabis audit program and consider Cannabis Assignment as a funding source; and
d. Provide direction as appropriate.

Sponsors:

Indexes:

Code sections:

Attachments: 1. Board Report, 2. A. Cannabis Program FY 22-23 Allocations and Related Job Work Tasks, 3. B. Measure Y, 4. Presentation Item No.pdf, 5. Completed Board Order Item No. 18

Date	Ver.	Action By	Action	Result
7/26/2022	1	Board of Supervisors	approved as amended	Pass

a. Receive a staff report for implementation of a payment plan option for commercial cannabis cultivation tax to address Fiscal Year 21-22 delinquent payments and additional options to retroactively reduce the tax rates to provide the industry with a fresh start in Fiscal Year 22-23; and
b. Consider other issues bearing on the Board’s decision on tax rates related to the commercial cannabis industry, including its data reporting practices; and
c. Support the creation of a commercial cannabis audit program and consider Cannabis Assignment as a funding source; and
d. Provide direction as appropriate.

RECOMMENDATION:

It is recommended that the Board of Supervisors:

a. Receive a staff report for implementation of a payment plan option for commercial cannabis cultivation tax to address Fiscal Year 21-22 delinquent payments and additional options to retroactively reduce the tax rates to provide the industry with a fresh start in Fiscal Year 22-23; and
b. Consider other issues bearing on the Board’s decision on tax rates related to the commercial cannabis industry, including its data reporting practices; and
c. Support the creation of a commercial cannabis audit program and consider Cannabis Assignment as a funding source; and
d. Provide direction as appropriate.

SUMMARY:

On June 21, 2022, the Board of Supervisors (Board) directed staff to prepare and present it with a report with specific options for a payment plan program for commercial cannabis business operators delinquent on their annual commercial cannabis cultivation business tax, assuming participants remain in good standing for the pendency of their plan. The Board also directed staff to provide options for the potential repercussions if an operator under a payment plan defaults.

Over the past weeks, staff met with the California Cannabis Authority (CCA) Executive Director (ED), County Administrative Office (CAO), Assistant County Administrative Officer, Office of the County Counsel (Counsel), Treasurer-Tax Collector (TTC) staff, and the County Budget Director multiple times to review options for the Program to present. Additionally, the Program met with some industry members and solicited their input.

Staff has prepared several options for the Board. Because staff has concluded that a payment plan program would likely increase both administrative costs and staff workload, as well as a heavy burden on operators that would be responsible for maintaining both a payment plan for past tax owed and staying current on new FY taxes, staff has also prepared cost effective alternatives for the Board to consider. These alternatives, depending on the details, could provide operators with a fresh start moving forward.

Additionally, the County has no way to verify the representations of operators with respect to their financial status. Staff therefore believes it is in the County's best interest to retain an outside consultant to conduct commercial cannabis reviews and audit some operators. These independent reviews would also provide the County with additional insight into cannabis businesses, help clarify emerging issues and industry needs, and better position the County to proactively support the industry going forward. Should the Board agree with this recommendation, staff recommends that the Board fund it with Cannabis Assignment funds.

DISCUSSION:

At the July 7, 2022, Board of Supervisors Cannabis Committee (Committee) meeting, members of the industry made several public comments stressing that, because of many factors, and especially volatile, depressed wholesale price points, they purportedly are unable to timely make commercial cannabis cultivation tax payments due on or before July 31, 2022. On July 12, 2022, the Program presented the Board with a status report on the proposed payment plan, reporting that staff required additional time to prepare meaningful options for the Board to consider.

Program staff has worked with TTC staff to develop four options. All options include estimated amounts collected to date for cultivation tax, assume 100% collection, but do not include penalties and interest. The options also do not include gross receipt collections for dispensary and manufacturing operators. As of Q3 FY 21-22, gross receipts collection is approximately $653,000 for the fiscal year. As an additional option, the Board may consider customizing a plan from elements of the options detailed below.

Option #1 Payment Plan Without Rate Reduction:

Fiscal Year (FY) 21-22 cultivation rates would remain unchanged. The County would implement a payment plan for delinquent cultivation operators with the following criteria applied to unpaid commercial cannabis business tax accounts, beginning with Q1 of FY 21-22:

- Payment plan details:
  - 25% down payment due on or before August 31, 2022. (recovery amount: $1,946,112).
  - Duration: 10 months; approximately $583k collected per month.
  - Existing delinquent penalties and interest would be waived if the agreement is successfully completed, and all payments are made timely.
  - If a payment is missed, the account would be considered delinquent and the business would be notified that the County will initiate shutdown procedures and notify the state Department of Cannabis Control (DCC) of its actions. All penalties and interest would be retroactively applied.
- Financial Impact: FY 21-22 commercial cannabis tax collected to date: $6,862,435.

- Total remaining commercial cannabis tax due by June 30, 2023: $7,784,448.
- Estimated FY 21-22 total commercial cannabis cultivation tax collected: $14,646,883.
- No refunds to operators that have previously paid under this option.

Equity Impact: This option could provide additional relief for up to 50 operators with unpaid commercial cannabis cultivation business taxes for FY 21-22. However, it arguably would present a competitive disadvantage to the 33 operators that timely paid cannabis cultivation taxes, as those operators have not had the benefit of diverting their tax payments to other expenditures. It is assumed that all operators with balances due could take advantage of this option.

Benefit to Operator:

- Retains Good Standing at state and local levels and provides additional time to pay balance due on FY 21-22 commercial cannabis cultivation tax without interest or penalties.

Benefit to County:

- Maximizes estimated FY 21-22 cannabis business tax revenue.
- Ensures recovery of some taxes owed as opposed to none for businesses that would otherwise shut down.

Consequences to Operator:

- Required down payment may be unavailable.
- Repayment period overlaps with the timeline that required infrastructure improvements need to be completed by for large cultivators to convert to annual licenses.
- Requires operators to make a monthly payment plan for FY 21-22 in addition to remaining current on annual cannabis cultivation tax for FY 22-23. At the Board of Supervisors meeting on July 12, 2022, operators requested a tax freeze for FY 22-23, stating that they would be unable to meet future tax obligations. This option would increase monthly tax obligations for operations in the next fiscal year.

Consequences for County:

- Added administrative costs to implement and maintain payment plans for nearly 90 operators.
    - May require funding for additional staff and/or outside contracting.
- No guarantee of full repayment as operators may quickly default on payment plan payments. Even with a payment plan, there is no guarantee that operators will be able to make plan payments in addition to current FY 22-23 installments due, which may still result in business closures and a loss in tax revenue.
- Fund balance would be reduced by $4,442,047 relative to original FY 21-22 cultivation revenue projection of $19,088,930.
    - This revenue loss may need to be subsidized by other discretionary revenue sources, but there are no impacts to operations because FY 21-22 has already closed.

Option #2 Retroactive Rate Reduction to FY 21-22 Quarter 1:

FY 21-22 rates for Quarters 1, 2, 3, and 4 retroactively amended to the $3/$2/$1 tax rates implemented for FY 22-23, i.e., $3 per square foot of indoor canopy, $2 per square foot of mixed-light canopy, and $1 per square foot of nursery canopy.

- Plan Details:
    - Reduced rate payment due on or before July 31, 2022. The Board could effectively extend this due date to October 31, 2022 via an Ordinance that extended the Board's existing waiver of penalties and interest for FY 21-22, quarters 2-4 for operators that pay their debt in full by July 31, 2022, to October 31, 2022. This would not require the establishment of a formal payment plan.
- No monthly payment plan.
- FY 21-22 commercial cannabis cultivation tax collected to date: $6,862,435.

- Total refunds due to operators that previously paid the higher rates: $1,219,060.
- Total remaining FY 21-22 commercial cannabis cultivation tax due by July or October 31, 2022: $2,364,987.
- Estimated FY 21-22 total commercial cannabis cultivation tax collected: $8,008,362.
- Equity Impact: This option would be applied to all cultivation accounts, so it would have no equity impact.

Benefits to Operator:

- Significantly reduces FY 21-22 cultivation tax burden by $5,419,461.
- Includes non-delinquent Operators, excluded from Option #1 because they paid timely.
- Avoids duplicative tax burden in FY 22-23 caused by a monthly payment plan program (Option #1).
- Allows Operators to quickly remediate FY 21-22 tax burden and start FY 22-23 in a current tax status.

Benefit to County:

- Avoids added administrative costs required to implement and administer payment plans and collects $2,364,987 within 1-3 months, rather than over 10 months, assuming full payment.
- Lower probability of default for some operators.

Consequences to Operator:

- Requires operators to pay total reduced cultivation tax owed while the market remains depressed and cash flow is extremely limited.
    - May impact ability of large cultivators to complete infrastructure improvements required to convert to annual licenses.

Consequences to County:

- Fund balance is affected by a $11,080,568 shortfall relative to original FY 21-22 cultivation revenue projection of $19,088,930.
    - This loss may need to be subsidized by other discretionary revenue sources, but there are no impacts to operations because FY 21-22 has already closed.
- Even at reduced rates, there is no guarantee that operators will be able to make payments; there may still be many business closures and a significant loss in tax revenue.

<u>Option #3: Retroactive Rate Reduction to FY 21-22 Quarter 2 (Existing Relief Period):</u>

FY 21-22 Quarters 2, 3, and 4 rates would be retroactively amended to the $3/$2/$1 model. This retroactive rate reduction would apply only to the quarters that the Board of Supervisors previously granted a conditional penalties and interest waiver.

- Plan Details:
    - Reduced rate payment due in full on or before July 31, 2022. The Board could extend this due date to October 31, 2022 without requiring formal payment plan. This plan would not include a monthly payment plan option.
- Financial Impact:
    - FY 21-22 commercial cannabis cultivation tax collected to date: $6,862,435.
    - Total refunds due to operators that previously paid the higher rates: $384,229.
    - Total remaining FY 21-22 commercial cannabis cultivation tax due: $3,986,397.
    - Estimated FY 21-22 total commercial cannabis cultivation tax collected: $10,464,602.
- Equity Impact: This option would be applied to all cultivation operators, so it would not have any equity impact.

Benefit to Operator:

- Significantly reduces FY 21-22 cultivation tax burden by approximately $4,182,281.

- Includes non-delinquent Operators who paid timely and are excluded from Option #1
- Avoids duplicative tax burden in FY 22-23 caused by a monthly payment plan program (Option #1).
- Allows Operators to quickly remediate FY 21-22 tax burden and start FY 22-23 in a current tax status.

Benefit to County:

- Avoids added administrative costs required to implement and administer payment plans and collects $3,986,397 within 1-3 months, rather than over 10 months.
- Lower probability of default for some operators.

Consequence to Operator:

- Requires operators to pay total reduced cultivation tax owed while the market remains depressed and cash flow is extremely limited.
    - May impact ability of large cultivators to complete required infrastructure improvements infrastructure to convert to annual licenses.

Consequence to County:

- Fund balance is reduced by $8,624,328 relative to the original FY 21-22 cultivation revenue projection of $19,088,930.
    - This loss may need to be subsidized by other discretionary revenue sources, but there are no impacts to operations because FY 21-22 has already closed.
- Even at reduced rates, there is no guarantee that operators will be able to make payments; there may still be many business closures and loss of significant tax revenue.

Option #4: Retroactive Rate Reduction to FY 21-22 Quarter 2:

FY 21-22 rates for Quarters 2, 3, and 4 could be retroactively reduced to $0 for all commercial cultivation tax rates.

- Plan Details: No further payments due for FY 21-22 and refunds to operators who previously paid. FY 21-22 commercial cannabis tax collected to date: $6,862,435.
- Total refunds due: $1,680,967.
- Total remaining delinquent commercial cannabis cultivation taxes due for FY 21-22 Q1: $444,496.
- Estimated FY 21-22 total commercial cannabis collected: $5,625,964.
- Equity Impact: This option would be applied to all cultivation operators, so there would be no equity impact.

Benefit to Operator:

- Significantly reduces FY 21-22 tax burden by approximately $9,020,919.
- Avoids the duplicative tax burden in FY 22-23 of making a FY 21-22 payment plan payment monthly in addition to current FY 22-23 quarterly cultivation tax payment.
- Refunds due in the amount of $1,680,967 to operators that paid timely.
- Allows Operators to quickly remediate FY 21-22 tax burden and start FY 22-23 in a current tax status.

Benefit to County:

- Avoids added administrative costs required by implementing payment plans.
- Higher probability of receiving the remaining FY 21-22 tax amounts due.

Consequence to Operator:

- Requires 9 operators who were delinquent in Q1 of FY 21-22 to become current to remain operational on or before July 31, 2022.
    - Of the 9, some are no longer operational, and one has paid the tax but owes penalties and interest.

Consequences to County:

- Fund balance is reduced by $13,462,965.93 relative to the original FY 21-22 cultivation cannabis tax

revenue projection of $19,088,930.
- The 9 operators who have been delinquent since Q1, outside the waiver period, may not be able to pay, which may result in business closures.
- This loss may need to be subsidized by other discretionary revenue sources, but there are no impacts to operations because FY 21-22 has already closed.

ADDITIONAL CONSIDERATION TO RATE OPTIONS: Rate Reduction through FY 22-23.
While this consideration does not address the issues surrounding the FY 21-22 delinquencies, it is being made part of this report as a possible alternative to provide relief to the cannabis industry.

FY 22-23 rates could be reduced to $0 for all commercial cultivation tax rates.
- Plan Details: No payment plan option.
- Financial impacts to FY 22-23: There would be significant impacts to the current FY budget including, but not limited to, the allocations that were approved in the FY 22-23 budget to be paid by commercial cannabis tax revenue.

Benefit to Operator:
- Enables all cultivators to redirect cash flow towards completing required infrastructure improvements infrastructure to convert to annual licenses.
- Avoids duplicative tax burden in FY 22-23 caused by a monthly payment plan program (Option #1).

Benefits to County:
- Encourages retention of local cannabis-related businesses and their respective workforces.
- Avoids added administrative costs required by implementing payment plans.

Consequences to Operator:
- The County will likely have higher expectations of an industry that has received such extensive local tax relief and may be less willing to extend additional relief in the future.

Consequence to County:
- $7.5 million in cannabis revenue in would not be available to fund operations approved in the adopted budget, so operations would have to be reduced.
- In 2018, the Board approved the Cannabis Program Strategic Plan, which includes Goal D: “Generate revenue to support the program and services to the public.”
    - If the Board were to approve reducing cultivation tax rates to $0 for FY 22-23, there would be very limited commercial cannabis tax revenue to support the program.
    - The following positions and services would be unfavorably impacted (Attachment A):
        - 25.23 FTEs allocated to work and support the Cannabis Program’s goals at a cost of $4.6 million and $1.5m in non-staff allocations.
        - 6 FTEs for non-cannabis work at a cost of $727,636 and $249,500 in non-staff allocations.
        - In the past, cannabis assignment has also been allocated to fund over $52 million dollars for community benefit; this would no longer be available.
    - The cannabis industry has changed greatly since 2016 but it remains complex; it is constantly evolving due to changes in state and federal law, market conditions, unexpected crises (such as the pandemic), and other factors. Regulation remains necessary to protect both the industry and the public. Without a Cannabis Program, there would be little to no regulatory oversight.

OTHER CONSIDERATIONS:
The Program continues to build its knowledge of many elements of this new industry, working with the overall commercial cannabis industry, individual operators, the DCC, and the California Cannabis Authority (CCA)

NCS Platform to name a few. Staff also continue to learn about key industry issues such as seed to sale transactions and historical and current wholesale price points. Below are additional considerations that are informed by these working relationships.

1. Sunsetting of state provisional licenses.
   In 2023, large permittees (those cultivating more than 22,000 square feet of canopy) must transition from state provisional to annual licensure. These large permittees will also need to fully comply with County requirements to obtain a land use permit (including meeting condition compliance), pay any related infrastructure improvement fees, and obtain a cannabis business permit from the County.
   a. If the local industry is unable to make timely commercial cannabis tax payments, they may be unable to satisfy local requirements and transition to state annual licensure. Some businesses may need to retool their business plans, while others may not be able to meet local requirements and, hence, be ineligible for state annual licensure.
   b. Several business closures are possible if operators cannot secure financing, pay cannabis tax payments, and/or complete all local compliance requirements.

2. There are anomalies and gaps in the monthly data provided to the CCA/NCS Platform by the industry.
   Several operators are not required to report monthly sales, either because they are exclusively making internal transfers, or because they are transferring product to a licensee that is located outside of the unincorporated area of Monterey County that is not required to provide its data. Additionally, it is unclear whether operators were reporting prices inclusive of the cultivation tax. Staff continues to improve their understanding of seed to sale transactions, but believes it needs additional time to further assess and refine the data before reporting back to the Board on this issue.
   a. Below are all the product categories tracked within the CCA NCS Platform, the database that aggregates Metrc (Track-n-Trace) data. Because Monterey County is predominantly cultivation oriented, the top 3 categories by volume are Leaf, Flower, and Fresh Cannabis Plant. There are significant variations in the average Flower price points reported by operators that the Program would like to research and analyze.
      i. Capsule
      ii. Clone - Cutting
      iii. Clone - Tissue Culture
      iv. Edible
      v. Extract
      vi. Flower
      vii. Flower (packaged - each)
      viii. Fresh Cannabis Plant
      ix. Immature Plant
      x. Kief
      xi. Leaf
      xii. Other Concentrate
      xiii. Pre-Roll Flower
      xiv. Pre-Roll Infused
      xv. Pre-Roll Leaf
      xvi. Seeds
      xvii. Seeds (each)
      xviii. Shake
      xix. Tincture
      xx. Topical

xxi. Vape Cartridge

b. There are multiple ways in which commercial cannabis goods can be sold, where value is primarily determined by the type of cultivation license, then by value added by processing and/or manufacturing activities. Below are the average price points (sold in pounds) reported in January - June 2022 for Flower by license and cultivation type. Staff does not include the very low price point and very high price points. The very high price points were errors in data entry that have recently been corrected.

i. Cultivator (Mixed Light)	$504	
ii. Processor (Mixed Light)	$463	
iii. Distributor (Mixed Light)	$666	
iv. Cultivator (Indoor)		$1,107
v. Distributor (Indoor)		$1,285

3. Governor's budget eliminating the state cultivation tax.
In December 2021, the industry requested that the County submit letters of legislative support to eliminate the State of California cultivation tax. Although the tax was eliminated beginning July 1, 2022, the industry claims that this has not helped, and will not help, cultivators as anticipated. Instead of providing relief of $161 per pound, the industry asserts that the savings from the elimination of the tax has primarily been absorbed by others (retail, for example) in an oversaturated buyer's market. Industry groups are reportedly encouraged to retain firm pricing, but this is undermined when operators make concessions to secure business. While the elimination of this production cost is not yet reflected at the retail level, lower consumer prices may eventually drive more consumer demand. Staff will continue to monitor the impacts of this change.

4. Some counties have retained outside consultants to conduct audits of commercial cannabis businesses.
Staff strongly believes Monterey County should follow their lead, either as to some or all operators. TTC has done a cursory review of outside consultants. Per Monterey County Code section 7.100.190 - Audit and examination of records and equipment, the TTC may:
"...examine all books and records of persons engaged in cannabis businesses, including both State and Federal income tax returns, California sales tax returns, or other evidence documenting the gross receipts of persons engaged in cannabis businesses, and, where necessary, all equipment, of any person engaged in cannabis businesses in the County, for the purpose of ascertaining the amount of commercial cannabis tax, if any, required to be paid by the provisions hereof, and for the purpose of verifying any statements or any item thereof when filed by any person pursuant to this Chapter."

5. Delinquent commercial cannabis operators.
Monterey County Code section 7.90.100(A)(21) states:

"A permittee shall not be delinquent in the payment of all applicable state taxes and fees, County taxes and fees, and other local agencies' taxes and fees."

Based on the Program's interpretation of this requirement and unless otherwise directed by the Board to amend the ordinance, delinquent operators would need to promptly cease operations.

6. Cannabis Program allocations and other revenue/expenditure reporting.
At the July 7, 2022 Committee meeting, the Program presented an update on the Cannabis Program FY 22-23 allocations because of suggestions regarding "right sizing" the Program. The current allocations including cannabis and non-cannabis staff allocations cost approximately $7.1 million dollars. The

Program met with all cannabis departments to review job descriptions and relates duties for each position funded by commercial cannabis tax revenue. (Attachment A). The Cannabis Committee emphasized the Board's original intent of these allocations; staff paid by commercial cannabis tax revenue should be 100% dedicated to cannabis work and work with the Program to meet its strategic goals.

The Auditor-Controller's Office (ACO) has been meeting with each cannabis department to review cannabis payroll overrides codes and similar override codes used to identify cannabis permits, licenses, expenditures, and create a paper-trail for non-staff allocations. The ACO will report back to the Committee on its findings in early fall.

Following extensive discussion with executive CAO management, the TTC, and the Budget Office, staff did not agree on a single option to recommend. The Program recommends Option 4. This option would provide the industry with immediate relief as they begin FY 22-23, which should enable them to satisfy requirements and convert to annual licensure. Although there are significant impacts to FY 21-22 revenue, this relief measure would empower the industry to complete the permitting and licensing processes and establish a foundation upon which to generate sustainable tax revenue and provide employment opportunities in FY 22-23 and beyond. Staff recommends that the Cannabis Assignment fund any necessary commercial cannabis cultivation tax refunds.

7. Measure Y.
   Voter approval of Measure Y was the foundational act that enabled the creation of the Monterey County Cannabis Program. Options to reduce the tax to $0 arguably contradict voters' understanding of Measure Y. For example, statements made by proponents of Measure Y that voters may have relied upon include that the tax would prevent operators from putting "a burden on funding for public services," would fund County services and offset "projected costs and demands on County services resulting from" cannabis businesses. (See Attachment B)

OTHER AGENCY INVOLVEMENT:
The County Administrative Office, Budget Office, Office of the County Counsel, Treasurer-Tax Collector, and California Cannabis Authority contributed to the preparation of the report, recommendations, and attachments.

FINANCING:
Any commercial cannabis business tax assessed for FY 2021-22 but not received by August 31, 2022, would have a direct impact on the FY 2021-22 ending general fund unrestricted fund balance. Option 1 would result in a funding gap of $4.4m, Option 2 would result in a funding gap of $11m, Option 3 would result in a funding gap of $8.6m, and Option 4 would result in a funding gap of $13.5m. The alternative consideration would result in a FY 2022-23 funding gap of $7.5 and would affect cannabis operations since limited cannabis funding would be available to fund the cannabis program. Note that the above estimates are reflective of cultivation tax only; they do not consider tax collected from gross receipts commercial cannabis operations such as dispensaries and manufacturers.

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: Cannabis Program FY 22-23 Allocations and Related Job Work Tasks
B: Measure Y