Cannabis Tax Review

February 28, 2023

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Recommended Actions

- Receive and review the Fiscal Analysis of the Commercial Cannabis Cultivation Industry report completed by HdL Companies
- Direct staff to amend Chapter 35 Cannabis Business Tax Ordinance

Background

- March 2017, voters approved Measure A, the Cannabis Business Tax
- June 2017, initial tax rates established by Ordinance 6188 using square footage model for cultivation
- March 2022, Board requested a review of the pros and cons of transitioning to a gross receipts taxation model for cultivation
- April 2022, 45% cultivation tax rate reduction effective July 1, 2021 through June 30, 2023

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HdL Report

- Out of 35 contacted, only 7 provided sufficient records to complete review
- County's cultivation tax is likely not the determining factor in a cultivation operation's success
- HdL identified a method to convert a gross receipts tax rate to a square footage tax rate
- Market price for outdoor cultivation is much lower than for indoor cultivation
  - Average indoor cultivation operation generates gross earnings of nearly $6 million
  - Average outdoor cultivation operation generates gross earnings of $355,000

Sample of Other Jurisdictions

- 11 counties/cities (not including Sonoma County)
  - 3 tax on square footage
  - 7 tax on gross receipts
    - 2 jurisdictions are transitioning/contemplating a change to the square footage model (Nevada and Santa Barbara Counties)

Program Costs

- Estimated program costs for FY23-24 are $2.2M increasing to $2.5M by FY27-28
- EIR and Program Update estimated costs of $2.3M over four fiscal years through FY24-25
- 15+ positions in five County depts.:
  - AWM
  - Permit Sonoma
  - CAO
  - Health Services
  - ACTTC
- Costs also include legal and contract services

Options

1. Maintain square footage model, but adjust rates based on HdL's tax rate convertor model, with annual review. Recommended rate of 2.5% gross receipts equating to:
   a. $0.75/sq. ft. for outdoor cultivation
   b. $12.50/sq. ft. for indoor cultivation
   c. $3.00/sq. ft. for mixed-light cultivation
2. Convert to Gross Receipts model (rate of 3%)
3. Extend 45% tax rate reduction with no other changes through FY 2023-2024, with additional HdL review

Option 1. Square footage model with tax rate convertor (rate of 2.5%)

Pros

- Adjusted rates will distribute tax burden more equitably across the cultivation types given different market prices
- Per HdL, cannabis businesses can deduct the tax as an expense under cost of goods sold (COGS) when reporting federal corporate income tax
- Budget preparation and revenue forecasting are more accurate and predictable based on permitted canopy
- No significant impact on staffing or administration

Cons

- Cultivators pay tax based on the privilege to grow; this tax is due whether or not they sell their product

Option 2. Convert to gross receipts model (rate of 3.0%)

Pros

- Cultivators will pay taxes commensurate with their sales

Cons

- Difficult to budget as market fluctuates and is unpredictable
- Difficult to ascertain validity of reported gross receipts
- Robust audit program is required. Would be a new program cost which would lead to a higher gross receipts tax rate (estimated at $200,000 annually).
- State's METRC track and trace system does not include data to determine gross receipts

Option 3. Maintain 45% tax rate reduction through FY23-24, with HdL review

Pros

- Maintains same level of relief already provided
- No significant impact on staffing or administration

Cons

- Does not provide additional tax relief
- Does not distribute the tax burden equitably across the cultivation types
- Does not provide for market price recovery

Staff Recommendation

1. Maintain square footage model, but adjust rates based on HdL's tax rate convertor model, with annual review. Recommended rate of 2.5% gross receipts equating to:
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Questions

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