



COUNTY OF SONOMA

575 ADMINISTRATION
DRIVE, ROOM 102A
SANTA ROSA, CA 95403

SUMMARY REPORT

Agenda Date: 3/15/2022

To: Board of Supervisors

Department or Agency Name(s): Auditor-Controller-Treasurer-Tax Collector, County Administrator, County Counsel

Staff Name and Phone Number: Christina Rivera 707-565-2431

Vote Requirement: Majority

Supervisorial District(s): All

Title:

Cannabis Tax

Recommended Action:

- A. Direct staff to amend Chapter 35 Cannabis Business Tax Ordinance to reduce the FY 2021/22 cultivation tax rates by 10%; and
- B. Direct staff to return by February 2023 with a review of the pros/cons of gross receipts vs. square footage tax assessment and recommendation to implement or not as of 7/1/2023.

Executive Summary:

Following the Board's January 4, 2022 discussion and direction, staff is returning with additional information and analysis. Given available accumulated Cannabis tax revenues in excess of estimated operating costs, staff recommends the Board, retroactively to 7/1/2021, reduce the FY 2021/22 cultivation tax rates by 10% by adopting an ordinance to amend Chapter 35.

In addition, consistent with the 6/6/2017 Board hearing staff report, documenting that Board's intent to transition to a cultivation gross receipts structure, we recommend directing staff to return by February 2023 with a review of the pros/cons of gross receipts vs. square footage tax assessment and recommendation to implement or not as of 7/1/2023. Including joining the California Cannabis Authority (CCA), which is a Joint Powers Authority established to collect and analyze data provided by the cannabis industry.

Both recommendations do not rely on non-Cannabis Board's discretionary funds. Staff projects these recommendations, if approved, can be absorbed within existing available Cannabis Tax fund balance, while still maintaining an available amount that is equal to at least 1.5 times the annual operating budgeted costs including new expenses associated with Gross Receipts auditing. See attachment A.

As a reminder, the Cannabis Business Tax was enacted solely for general governmental purposes for the county and not for specific purposes.

Discussion:

- I. BACKGROUND

On January 4, 2022 <<https://sonoma-county.legistar.com/LegislationDetail.aspx?ID=5367917&GUID=4A4A3E7B-9878-4186-AB33-35FB939129F5&Options=&Search=>>>, the Board of Supervisors considered requests from legal Cannabis industry representatives to revise the County's cannabis business tax structure. The requests were derived from the industry-reported per pound price drop,

Agenda Date: 3/15/2022

and as a reaction to the state’s January 1, 2022 cultivation tax rate increase. Subsequently, in compliance with the Board’s direction, on January 25, 2022, the [Board adopted resolution # 22-0022 extending <https://sonoma-county.legistar.com/LegislationDetail.aspx?ID=5383634&GUID=426550C7-336A-4A6F-8A09-C68A489E22E5&Options=&Search=>](https://sonoma-county.legistar.com/LegislationDetail.aspx?ID=5383634&GUID=426550C7-336A-4A6F-8A09-C68A489E22E5&Options=&Search=>) the January 31, 2022 tax installment due date for all Cannabis Business Taxes to April 30, 2022. Because of this action, operators have the option to pay the January 31, 2022 tax installment and the April 30, 2022 tax installment by April 30, 2022 without penalties or interest. The Board also directed staff to bring forward an item prior to April 30, 2022 to further discuss options and possibly further extend tax installment due dates.

Current Operators Recap

2021-2022 DATA		
Operation Types	Permits	Total square footage
Manufacturer	5	
Dispensary	5	
Cultivation:		
Indoor	19	67,391
Mixed Light	11	85,058
Outdoor	141	1,910,387
Grand Total	183	2,062,836

Attachment B includes tax collections for the last 3 fiscal years.

The 1/4/2022 report provided an overview of the cultivation tax structures in place for both the state and the county’s unincorporated area; identified policies issued by neighboring municipalities and preliminary legislation discussion by Senator McGuire. The 1/4/2022 staff presentation included a mock example of an operator’s annual state and unincorporated tax. The mock example showed that of an estimated \$40,700 annual total tax; \$8,450 or 21% is levied to a cultivator by the county.

Subsequently, staff has tracked other jurisdictions’ recent tax changes (including neighboring counties and three Sonoma County cities administering a cannabis business tax) regarding cannabis business taxes. The following bullet points summarize the actions taken by the 14 total jurisdictions (note: some jurisdictions have implemented multiple actions):

- 8 jurisdictions have not taken action
- 4 jurisdictions have requested action at the State level
- 3 have provided tax relief by postponing either tax payment due dates or implementation of tax
- 4 have established provisional relief by either reducing tax rates or suspending annual inflators

In addition, mention of upcoming state tax relief efforts was included in the Governor’s January Budget release, and most recently, Senators Dodd and McGuire have introduced [legislation <https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220SB1074>](https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220SB1074) (SB 1074) to provide such relief. See attachment C.

II. STAFF RESPONSES TO 1/4/2022 BOARD QUESTIONS

1. What were the original estimates that went into the expected use of the taxes?	Initial estimates included program implementation costs for various staff positions in PRMD, AWM, DHS, County Counsel, ACTTC, and EDB in the amount of \$2.7 million. Program management costs continue in the departments (with the exception of EDB as those positions now reside at the CAO). See Attachment D.
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2. How is code enforcement funded?	1.5 Code Enforcement Inspector positions dedicated to cannabis enforcement in PRMD are funded from the Cannabis Tax Fund, a \$265,000 annual cost.
3. Can we confirm market price?	Other than asking cultivators directly, we have not located an official non-industry sponsored historical market prices database.
4. Could we establish a formula for gross receipts method with some protections such as CPI?	Yes, if the Board directs. Please review the following section discussing transition to Gross Receipts.
5. Were there promises made to move to gross receipts upon the implementation of the track and trace system (METRC)?	Yes. On 6/6/2017, as part of the Board adoption of Chapter 35 Cannabis Business Tax, the included staff recommendation stated, "Move forward with square footage tax until a track and trace system is in place that allows the county to adequately track cannabis production to ensure accurate gross receipts reporting." As of the writing of this report, staff has learned that the State's proprietary METRC track and trace system is used exclusively to track commercial cannabis movement across the distribution chain ("seed-to-sale"), and does not include gross receipts data from operators. However, staff did identify the possibility that becoming a member of the California Cannabis Authority (a Joint Powers Authority created to provide data analysis and facilitate compliance for cannabis programs) may provide the data, if we require our operators to submit their financials.
6. What is the state going to do?	The Governor's January 2022 budget release indicates interest "...to make modifications to California's cannabis tax policy to help stabilize the market." Further, recent legislation has been submitted by Senators Dodd and McGuire - see link above.
7. Where is the sweet spot to keep people from going into the illegal market?	Staff does not have sufficient data or independent expert resources to answer this question.
8. How will we float [finance] reduction/pause of taxes?	With available accumulated one-time Cannabis Tax fund balance generated mainly from FY 2020-21 tax remittances. See attachment A.

III. CULTIVATION TAX RELIEF AND TRANSITION TO GROSS RECEIPTS

Given the Governor's administration plans to work with legislators to provide state tax relief, the table below presents implementable current year tax relief measures for cultivators only. Additionally, given the 6/6/2017 Board hearing staff report documented that Board's intent to transition to a cultivation gross receipts structure, staff presents an implementable approach with an effective date of 7/1/2023.

Cultivation Tax Relief

MEASURE	OUTCOME	ESTIMATED FISCAL IMPACT	BOS ACTION NEEDED
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Agenda Date: 3/15/2022

<p>A) Suspend the 3.18% Consumer Price Index (CPI) annual rate adjustment for FY 2021/22</p>	<p>Retracts FY 2021/22 annual automatic rate increase</p>	<p>\$110,000 Cultivation tax is about 85% of prior year revenue collections. Available one-time accumulated on-hand balance can absorb impact.</p>	<p>1) 4/5/2022 regular calendar resolution introducing and waiving further reading of ordinance change; and 2) 4/19/2022 resolution to extend 1/31/22 and 4/30/22 installment due dates to 5/30/2022.</p>
<p>B) Reduce pre-CPI adjusted tax rate by 682 basis points (or 6.82%) which together with the annual CPI suspension will total a 10% rate relief for FY 2021/22.</p>	<p>Provide tax relief to cultivators towards current fiscal year accumulated.</p>	<p>\$252,000 Cultivation tax is about 85% of prior year revenue collections. Available one-time accumulated on-hand balance can absorb impact. <i>Every 1% adjustment down is projected to reduce current year revenues by ~\$37,000.</i></p>	<p>1) 4/5/2022 regular calendar resolution introducing and waiving further reading of ordinance change; and 2) 4/19/2022 resolution to extend 1/31/22 and 4/30/22 installment due dates to 5/30/2022.</p>

Alternatively, should the Board prefer to focus tax relief on only the most affected cultivation operators, the Board may instead direct staff to create a first come first serve Tax Relief application program.

The main criteria to be eligible for tax relief is to undergo an audit that verifies Sonoma County’s unincorporated annual tax liability was exclusively responsible for the cultivator to operate at a significant deficit from July 1, 2020 through June 30, 2021. Thus, the relief will be the lesser of the total tax liability accrued for FY 2020/21 or the demonstrated deficit. The program will be set up as an opt-in and on a first come first serve basis, which will not cumulatively exceed 20% of the FY 2021/22 budgeted tax revenue or \$500,000. Implementation of this program will require additional audit services, which may cost up to \$20,000 per audit depending on the size and complexity of operations. Together the cap of \$500,000 total FY 2021/22 tax relief and estimated \$200,000 audit reviews (up to 10 audits) can be absorbed within available accumulated tax fund balance. As a reference, please note that the Humboldt County Board of Supervisors adopted an opt-in program to delay payment of the tax year 2021 and 2022 excise taxes until calendar year 2024.

Gross Receipts

As noted in the 6/6/2017 Board report establishing the County’s Cannabis Business Tax and regulations, the Board then established initial cultivation rates intended to equate to a 3% tax on gross receipts. The 6/6/2017 summary report (Attachment E) documents the intent to transition to cultivation gross receipts tax structure once the state’s track and trace system was in place that would allow the County to adequately track cannabis production and to ensure accurate gross receipts reporting. As of this writing, it is staff understanding that the state’s chosen software system [METRC <https://www.metrc.com/partner/california/>](https://www.metrc.com/partner/california/) is still undergoing updates based on recent changes at the State (DCC); operators’ self-reported data; and the data does not include gross receipts information. Thus, at this time, is it staff’s conclusion METRC is not yet an independent source of gross receipts on which to base taxes.

Staff recommends returning by February 2023 with a review of the pros/cons of gross receipts vs. square footage tax assessment and recommendation to implement or not as of 7/1/2023. Thus, for FY 2022/23 budgeting, staff will:

1. Engage a consultant to assist with a gross receipts vs. square footage analysis in order to make a recommendation to the Board by February 2023; and, on a sampling basis, audit/review the financial records of cultivation operators to gain an understanding of financial records, determine the basis for calculating gross receipts, and estimate total gross receipts for rate setting purposes. Estimated cost for auditing services is \$200,000.
2. Determine the appropriate gross receipts tax percentage rate to support the County’s cannabis program.

3. Apply for membership in the [California Cannabis Authority <https://cca.ca.gov/>](https://cca.ca.gov/) (a Joint Powers Authority established to provide data collection and analysis and to facilitate compliance) at a cost of \$128,000 for the fiscal year.

Without relying on the Board’s discretionary funds, the estimated fiscal impacts from suggested current year cultivation tax rate relief, and costs identified to begin the transition to a cultivation tax rate based on gross receipts can be absorbed by on-hand accumulated Cannabis Tax fund balance, which experienced significant growth in the 2020/21 fiscal year.

Strategic Plan:

N/A

Prior Board Actions:

01-04-2022 Board Discussion on Cannabis Tax Structure

01-25-2022 Resolution extending the quarterly Cannabis Tax payment due date from January 31, 2022 to April 30, 2022

FISCAL SUMMARY

Expenditures	FY 21-22 Adopted	FY22-23 Projected	FY 23-24 Projected
Budgeted Expenses	\$32,000		
Additional Appropriation Requested		\$331,840	\$335,795
Total Expenditures	\$32,000	\$331,840	\$335,795
Funding Sources			
General Fund/WA GF			
State/Federal			
Fees/Other	(\$362,340)	(\$362,340)	(\$362,340)
Use of Fund Balance	\$394,340	\$694,180	\$698,135
Contingencies			
Total Sources	\$32,000	\$331,840	\$335,795

Narrative Explanation of Fiscal Impacts:

Reduced ongoing projected revenue resulting from proposed permanent rate adjustment and increased costs estimated for Gross Receipts review can be absorbed with existing Cannabis Tax fund balance. See Attachment A.

Staffing Impacts:			
Position Title (Payroll Classification)	Monthly Salary Range (A-I Step)	Additions (Number)	Deletions (Number)

Narrative Explanation of Staffing Impacts (If Required):

None

Attachments:

Agenda Date: 3/15/2022

Attachment A - Cannabis Tax Fund Estimates

Attachment B - Cannabis Tax Collections for last 3 Fiscal Years

Attachment C - Other California Jurisdictions' Actions Taken Regarding Cannabis Taxes

Attachment D - April 11, 2017 Cannabis Ad Hoc Committee Charter and Program Implementation Board of Supervisors Summary Report

Attachment E - June 6, 2017 Cannabis Business Tax Ordinance Board of Supervisors Summary Report

Related Items "On File" with the Clerk of the Board:

None