



Legislation Text

File #: 2024-0303, **Version:** 1

To: Board of Supervisors

Department or Agency Name(s): County Administrator's Office

Staff Name and Phone Number: McCall Miller, 707-565-2431

Vote Requirement: Majority

Supervisorial District(s): Countywide

Title:

Cannabis Business Tax Ordinance (Chapter 35 of the Sonoma County Code) Amendment - First Reading

Recommended Action:

- A) Consider an Ordinance amending Chapter 35 of the Sonoma County Code, the Cannabis Business Tax Ordinance, to establish new tax rates for cannabis cultivation, cannabis retail (dispensary) and cannabis manufacturing operations, effective July 1, 2024; and
- B) Adopt a Resolution introducing, reading the title of, and waiving further reading of a proposed ordinance amending Chapter 35 of the Sonoma County Code.

Executive Summary:

On May 23, 2023, the Board adopted Ordinance 6433, amending Sonoma County Code Chapter 35 (Chapter 35) to set the cannabis cultivation tax rates as follows, effective July 1, 2023: Outdoor cultivation, rate of \$0.75/sq. ft.; Mixed-Light cultivation, rate of \$3.00/sq. ft.; and Indoor cultivation, rate of \$12.50/sq. ft.

As part of the adoption of Ordinance 6433, the new tax rates that the Board instructed staff to adopt were based on maintaining the square footage taxation model using outside consultant HdL Companies' tax rate convertor model, with an annual review in an effort to be responsive to expected market changes. HdL Companies conducted the annual review in March 2024. This item presents options for the Board's consideration.

Additionally, administrative changes are proposed for consistency and to correct typographical errors.

Discussion:

History

The Cannabis Business Tax (Measure A) was passed by voters in the March 7, 2017 special election with 71% voter approval. Measure A laid out a framework for taxation that set maximum allowable rates for all operator types and granted authority to the County to, among other things, set lower rates, tax certain operator types, and establish various tax administration policies.

- On December 13, 2016, Ordinance 6188 imposed a cannabis business tax on commercial cannabis businesses, which established Chapter 35.
- On June 13, 2017, Ordinance 6203, amended Chapter 35, setting cannabis business tax rates within the voter-approved maximum rates, and establishing certain regulations.
- On August 28, 2018, Ordinance 6241, amended Chapter 35, to make administrative changes.

- On April 19, 2022, Ordinance 6374, amended Chapter 35, to temporarily reduce the cultivation tax rates by 45 percent and make administrative changes.
- On May 23, 2023, Ordinance 6433, amended Chapter 35, setting the cannabis cultivation tax rates as follows, using the tax rate convertor model (2.5% gross receipts converted to square footage tax), effective July 1, 2023:

Permit Type	Rate Per Square Foot	Effective July 1, 2023
Outdoor		\$ 0.75
Mixed-Light		\$ 3.00
Indoor		\$ 12.50

March 2024 Annual Cultivation Tax Analysis

To gather relevant cannabis cultivation data, a Cannabis Cultivation Questionnaire was sent to all permitted cannabis cultivation operators via email addresses included in the cannabis permit applications (75 operations including over 110 email addresses). Participation in and completion of the questionnaire was voluntary. Staff emailed operators a total of three times over a period of two weeks to encourage participation and completion of the questionnaire. A total of 11 responses (15% of total operations) were received (see table below). In comparison, seven operators (6% of total operations) provided information for the February 2023 analysis.

Operation and response information by cultivation type

Cultivation Type	Number of permitted operations	Number of operator responses	Percent of responses compared to permitted operators
Outdoor	57	7	12%
Mixed-Light	4	1	25%
Indoor	14	5	36%

Note: Multiple operators are permitted for multiple types of cultivation. Two operators reported multiple cultivation types.

Highlights from the HdL Companies review:

- The County of Sonoma as a whole has a robust cannabis industry.
- The reported average size of cultivation operation is significantly smaller in 2024 than in 2023: unincorporated total outdoor cultivation size decreased by 31% and indoor cultivation size decreased by 85% (there was no mixed-light cultivation size recorded for 2023).
- The average price per pound for indoor cannabis saleable product decreased dramatically from \$1,230 in 2023 to \$606 as reported for this analysis. Although the price for outdoor large flower/bud has increased from \$308 to \$462, this product accounts for a small subset of saleable product, therefore the average price for outdoor cannabis products has also decreased from \$308 to \$277 (there was no mixed-light sales information recorded for 2023).

Cannabis Supply Chain (Retail and Manufacturing) Tax Rates

In addition to reviewing the cannabis cultivation tax rates, staff reviewed the tax rates for the cannabis supply

chain, specifically the tax rates for retail (dispensary) and manufacturing operations. The table below shows tax rates by jurisdiction within Sonoma County. More detailed information can be found in Attachment E.

Retail and Manufacturing Tax Rates by Jurisdiction within Sonoma County

Jurisdiction	Retail Tax Rate	Manufacturing Tax Rate
Cloverdale	3.5%	1.0%
Cotati	3.0%	1.0%
Healdsburg*	4.0%	2.0%
Santa Rosa	3.0%	1.0%
Sonoma*	4.0%	4.0%
Unincorporated County	2.0%	3.0%
Average Tax Rate (not including Unincorporated County)	3.5%	1.8%

*Note: There are no manufacturers operating in the City of Sonoma. There are no retail operations (dispensaries) operating in the City of Healdsburg.

The current cannabis retail (dispensary) tax rate of 2% is the lowest in Sonoma County and among the lowest in the state. The current cannabis manufacturing tax rate of 3% is second highest in Sonoma County and in the median for the state. A sample of tax rates from around the state are included in Attachment E.

Staff reached out to licensed retail (dispensary) operators and manufacturers to discuss these tax rates. Two key takeaways from those conversations:

- Retail operators are concerned about how an increase in local tax rate would compound the effects of existing multiple taxes on retail operations.
- Manufacturing operators are exploring moving their operations to Santa Rosa based primarily in the tax rate.

Based on FY 22-23 cannabis business tax revenues (five retail operations and five manufacturing operations), an adjustment of the retail (dispensary) tax rate from 2% to 3% would equal approximately \$160,000 in increased revenue; and an adjustment of the manufacturing tax rate from 3% to 1.5% would equal approximately \$30,000 in decreased revenue; with a net projected revenue increase of approximately \$130,000.

Chapter 35, Cannabis Business Tax Ordinance

The Cannabis Business Tax Ordinance includes a provision for an annual adjustment of square-footage based cannabis cultivation tax rates on July 1 of each fiscal year by the most recent Consumer Price Index (CPI) for the San Francisco-Oakland-San Jose area. If no action is taken today, the cultivation tax rates will automatically be raised on July 1, 2024 by the most recent CPI, which is 2.4 as of the February 2024 published rate.

Sonoma County Cannabis Tax Fund Budget and Program Costs

The cannabis program costs are funded by cannabis business tax revenues and program tax fund balance. As taxable canopy declined by 1/3rd in FY 23-24 (similar to the decrease experienced in FY 22-23), the program has relied on and will continue to rely on fund balance to make up the difference which, with current

assumptions, will sustain the program through FY 26-27. Projections include that in June 2021, the Board committed fund balance to the Cannabis Program Update and Environmental Impact Report effort to be financed with an estimated total cost of \$2.6 million through FY 24-25.

Cannabis program costs include staff in five County departments, legal costs (County Counsel and external counsel), other contract services, and the Environmental Impact Report and Cannabis Program Update (See Attachment D). Estimated program costs start at \$1.7 million for FY 24-25, increasing to \$1.8 million in FY 26-27. Department costs for the Department of Health Services Environmental Health Division and Department of Agriculture / Weights & Measures (AWM) are offset by permit fees. Permit Sonoma permit fees are not included as those permits are at-cost billed to the applicants. However, code enforcement costs for 1.5 full-time equivalent positions are financed by revenues from the cannabis tax fund.

Options and Staff Recommendation

Based on the analysis, staff developed and evaluated the following options, in conjunction with information received from HdL, and determined the advantages and disadvantages of each option.

Options:

1. No change to the ordinance, allowing the annual CPI adjustment to occur.
2. Maintain current tax rates, not allowing the annual CPI adjustment to occur.
3. Adjust all cannabis tax rates.

Staff Recommends Option 3

Options 1 and 2 are not recommended as they are not responsive to market price changes for cultivation as reported in HdL’s March 2024 review. Based on the analysis, staff recommends Option 3 as it aligns with the existing cultivation tax rate of 2.5% gross receipts (converted to square footage) and brings the County’s taxation rates in closer alignment with the taxation rates for retail (dispensary) and manufacturing operations within the cities. This option is within the scope of authority granted to the Board of Supervisors by the voters in approving the cannabis business tax. Recommended Tax Rates:

- Supply Chain Tax Rates
 - Retail (dispensary): 3%
 - Manufacturing: 1.5%
- Cultivation Tax Rates
 - Outdoor cultivation - \$0.69/sq. Ft.
 - Mixed-Light cultivation - \$2.51/sq. Ft
 - Indoor cultivation - \$7.58/sq. Ft.

Below is projected cannabis business tax revenue for FY 24-25.

Cannabis Business Type	Projected Tax Revenue
Cultivation Type and Tax Rate	FY 24-25
Outdoor \$0.69/sq. ft.	\$420,790
Mixed-Light \$2.51/sq. ft.	\$17,494
Indoor \$7.58/sq. ft.	<u>\$303,770</u>

Total projected cultivation tax revenue	\$742,054
Supply Chain Operation type	
Retail (dispensary) 3%	\$582,284
Manufacturing 1.5%	\$32,913
Total projected supply chain tax revenue	\$615,197
Total projected cannabis tax revenue	\$1,357,251

Note: An additional retail (dispensary) operation commenced operations in October 2023, increasing the number of operating retail (dispensary) operations from five to six and increasing the projected tax revenue. Assumptions for cultivation tax revenue are based on known verified taxable canopy for FY 23-24. Canopy for FY 24-25 will be verified throughout the fiscal year.

Although it is difficult to predict numerous factors, including when the market price of cannabis will rebound, whether verified and taxable canopy numbers will increase, and what the program update will include, staff has taken a conservative approach. Based on current assumptions, the projected tax revenue at the recommended adjusted rates and year-end estimated FY 23-24 fund balance will meet the projected annual cannabis program escalated costs through FY 26-27. Staff will continue to track program costs and revenue and will return with program operational adjustments as necessary. Cannabis Tax Fund budget information is included in Attachment D.

Administrative Changes

In addition to the new rates, the Ordinance amendments include administrative changes for consistency and clarity with other taxes administered by the Tax Collector. Below are the key proposed changes to the Ordinance, with a redlined version of the existing Ordinance attached (Attachment C).

- Amends the language regarding a restriction on the waiver of penalties and interest;
- Amends the language regarding the date from which the County will provide a refund if a County error attributes to an overpayment; and
- Changes minor typographic errors.

Strategic Plan:

N/A

Racial Equity:

Was this item identified as an opportunity to apply the Racial Equity Toolkit?

No

Prior Board Actions:

5/23/2023 - Adopted Cannabis Business Tax Ordinance, amending cannabis cultivation tax rates effective July 1, 2023 (

[<https://sonoma-county.legistar.com/LegislationDetail.aspx?ID=6208098&GUID=F1689D18-7F34-4AA5-9531-0A9A17C47910&Options=&Search=>](https://sonoma-county.legistar.com/LegislationDetail.aspx?ID=6208098&GUID=F1689D18-7F34-4AA5-9531-0A9A17C47910&Options=&Search=>))

2/28/2023 - Cannabis Business Tax Review, Discussion, and Direction to Staff (

[<https://sonoma-county.legistar.com/LegislationDetail.aspx?ID=6033142&GUID=FD98F6CE-92F7-45FA-8D3D-A2E06890A3B8&Options=&Search=>](https://sonoma-county.legistar.com/LegislationDetail.aspx?ID=6033142&GUID=FD98F6CE-92F7-45FA-8D3D-A2E06890A3B8&Options=&Search=>))

FISCAL SUMMARY

Expenditures	FY23-24 Adopted	FY24-25 Projected	FY25-26 Projected
Budgeted Expenses			
Additional Appropriation Requested			
Total Expenditures		\$0	\$0
Funding Sources			
General Fund/WA GF			
State/Federal			
Fees/Other		\$1,400,000	\$1,400,000
Use of Fund Balance		\$320,000	\$365,000
General Fund Contingencies			
Total Sources		\$1,400,000	\$1,400,000

Narrative Explanation of Fiscal Impacts:

There are no new expenditures related to the implementation of the new tax rate as the taxation methodology is unchanged. Projected cannabis tax revenue for FY 24-25 and FY 25-26 is \$1.4 million and will be revised as cannabis cultivation canopy (taxable) is verified and as operators provide gross receipt information. Annual cannabis program costs will be supplemented with cannabis tax fund balance in the amount of approximately \$320,000 in FY 24-25 and \$365,000 in FY 25-26, which, due to program adjustments is less than the previously \$700,000 projected shortfall.

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

Narrative Explanation of Staffing Impacts (If Required):

N/A

Attachments:

- Attachment A - Draft Cannabis Business Tax Ordinance
- Attachment B - Resolution introducing, reading the title of, and waiving further reading of the proposed Cannabis Business Tax Ordinance
- Attachment C - Redline version of existing Cannabis Business Tax Ordinance
- Attachment D - Cannabis Tax Fund Budget
- Attachment E - Other Jurisdictions Cannabis Tax Rates
- Attachment F - HdL Companies 2024 Report

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

None