



BOARD OF SUPERVISORS  
AGENDA LETTER

Agenda Number:

Clerk of the Board of Supervisors  
105 E. Anapamu Street, Suite 407  
Santa Barbara, CA 93101  
(805) 568-2240

**Department Name:** County Executive Office  
**Department No.:** 012  
**For Agenda Of:** January 9, 2018  
**Placement:** Departmental  
**Estimated Time:** 90 minutes  
**Continued Item:** No  
**If Yes, date from:**  
**Vote Required:** Majority

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**TO:** Board of Supervisors

**FROM:** Department            Mona Miyasato, County Executive Officer  
Director(s)  
Contact Info:            Dennis Bozanich, Deputy County Executive Officer

**SUBJECT:**    **Taxation of Cannabis-related Operations: Additional Options and Operational Issues**

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**County Counsel Concurrence**

As to form: Yes

Other Concurrence: Treasurer-Tax Collector

As to form: Yes

**Auditor-Controller Concurrence**

As to form: Yes

**Recommended Actions:**

That the Board of Supervisors (Board):

- A. Consider options for taxation rates and provide direction to staff for inclusion in a June 2018 ballot measure
- B. Provide direction to staff for:
  - i. Development of a measure for General revenue purposes; OR
  - ii. Development of a measure for Specific revenue purposes; and conceptual direction on the specific uses and conditions for the revenue;
- C. Direct staff to return on January 30, 2018 with a taxation ordinance and ballot measure on cannabis-related operations.
- D. Receive a presentation on additional cannabis revenue banking, treasury and accounting issues;
- E. Provide any other conceptual direction to staff; and
- F. Determine, pursuant to the California Environmental Quality Act (CEQA) Guidelines 15378(b)(5), that the above actions are not a project subject to CEQA review because they are administrative activities that will not result in direct or indirect physical changes in the environment.

**Summary Text:**

On December 14, 2017, the Board of Supervisors held a Special Meeting to consider a variety of cannabis-related revenue and fee estimates. The Board directed staff to:

- (1) Further discuss taxation rates and to return on January 9, 2018 with additional options for the Board discussion and conceptual direction, and
- (2) Hear from Treasurer Tax Collector on frequency of tax collection

There was unanimous support for other elements of a tax structure and a ballot measure (described below) but only conceptual majority support for a general revenue purpose tax (which will require 4/5 vote of the Board). Therefore staff is requesting the Board give direction as to the type of revenue measure (General or Special), and if a Special Revenue measure, provide conceptual direction on the types of uses. Staff will return on January 23, 2018 for language on the specific types of uses for the tax revenue.

This agenda item provides the Board additional taxation options and information on issues related to the collection and accounting for tax and fee revenues derived from cannabis operations. Further direction to staff is requested to move forward to meet deadlines necessary for a June 2018 ballot measure.

**Background:**

On December 14, 2017, the Board was provided an economic and taxation analysis by HdL. The Board also received a preliminary analysis of staffing requirements to address a possible regulated cannabis market (Licensing and Compliance) and staffing to address the certain unregulated cannabis market (Enforcement). Staff provided a general recommendation for the development of a gross receipts-based tax for various cannabis-related operations in the unincorporated area of Santa Barbara County. The Board also provided conceptual direction to staff on a variety of policy and operational areas that would be critical in the development of any proposal for a ballot measure to tax cannabis operations.

**Conceptual Consensus on Cannabis Taxation Measure**

On December 14<sup>th</sup>, the Board was presented a series of options and decision points important to the development of a possible ballot measure to tax cannabis operations. As a result of the conceptual direction during deliberations on December 14<sup>th</sup>, the following areas had unanimous or nearly unanimous support:

1. Ballot measure should be on the June 2018 Primary Election ballot;
2. Licensing and permitting of cannabis operations would be contingent on voter approval of the cannabis operations tax (this would be included in the ordinance regulating cannabis operations);
3. Tax on gross receipts for all operator types;
4. No “not to exceed” rate (Also, see discussion below on tax rate cap for vertical integration);
5. No “Sunset” or expiration date for the tax;
6. Tax would apply uniformly to medical and non-medical cannabis operations;
7. Tax would only apply to operations in the unincorporated portions of Santa Barbara County;
8. Hear from the Treasurer-Tax-Collector about any issues or concerns related to tax collection, and

9. Direction to the Auditor-Controller to prepare a fiscal impact statement for the ballot pamphlet

The Board discussed the following concepts:

- Ballot measure should be developed as a General tax measure, which would require a 4/5 vote of the Board and a +50% voter approval;
- Staff should develop a tax rate cap or other mechanism so that cannabis entities that hold more than one license in the supply chain (“vertically integrated”) wouldn’t pay the tax at every step in the supply chain; and
- County taxes should not exceed an amount whereby the state and local accumulated tax rate exceeds 30%.

The Board may consider additional conceptual direction to staff on these consensus items. However, to meet legal and administrative deadlines for placing a measure on the June 2018 ballot, staff requests the Board now provide tax rates and determine whether the ballot measure should be developed as a General tax or a Special tax. If a Board majority determines a Special tax should be placed before the voters, then additional guidance will be needed on the identified “special” uses for any cannabis tax revenue.

### **Cannabis Taxation Rate Options**

On December 14, 2017, staff recommended establishing a gross receipts tax on cannabis operations. Staff had recommended rates of 2% for nurseries and distributors, 4% for all cultivators and 6% for manufacturers and retailers. Further, if the Board wanted to establish a “not to exceed tax rate,” staff recommended a “not to exceed tax rate” of 8%. The Board received testimony from the contract consultant from HdL that the new State regulations provided an incentive for “vertical integration” (i.e. a single entity that possesses more than one type of cannabis license in the supply chain) and that vertical integration would benefit from a tax system that uses a common basis for applying the tax to different license types (e.g. gross receipts or weight) rather than different basis (e.g. square footage, gross receipts) for different license types as many jurisdictions had done in the past.

The Board also received public comment that the taxes, if all added together would exceed thresholds believed to encourage participation in the regulated cannabis market. Other public comment encouraged further discussion to arrive at tax rate options that could be considered. Staff was directed to have further discussions and return with tax rate options on January 9, 2018.

After further consideration, research into other jurisdictions and discussion with representatives from the cannabis operators, staff is presenting two additional options. Option 1 is NOT recommended. Option 2 is recommended.

#### **Option 1 - Industry Proposal:**

- Phase in taxes over three years;
- Maximum gross receipts tax rates cap at 8% for any license type;
- Nurseries tax at 1% of gross receipts
- Cultivation tax at 3% of gross receipts;
- Manufacturing at 2% of gross receipts;
- Distributor tax at 0-1% of gross receipts depending on transport only licenses;

- Vertical integration cap of 4% based on a specifically defined set of license types to define “vertical integration.”

**Option 2** - Revised version of December 14<sup>th</sup> Staff Recommendation (with strikethrough and underlined changes) on discussion with industry since December 14th:

- 1% ~~2%~~ gross receipts tax on nursery and distributor (non-transporter) license types;
- 4% gross receipts tax on cultivator and manufacturer license types;
- 6% gross receipts tax on ~~manufactures~~ and a retailer license type; and
- Vertical integration cap (same licensee holding three or more license types) that limits gross receipts tax maximum of 8%.

### **General or Special Tax on Cannabis Operations**

On December 14, 2017, the Board discussed and seemed interested in having voters consider a General tax measure. However at the end of deliberations, there did not appear to be sufficient consensus for direction to staff to prepare a General tax measure for the ballot in June 2018. During brief discussions about creating a Special tax, some members of the Board offered general definitions of a specific purpose for any tax revenue.

If the Board chooses to proceed with a special tax, the Board will need to identify

- (1) The specific uses of any tax revenue;
- (2) Allocation method; and
- (3) Consider a mechanism to confirm annual spending in line with the ballot measure.

Given the uncertainty of the future cannabis market, and HdL’s information that supply will exceed demand in California, the CEO strongly recommends that the revenues not be allocated entirely for ongoing programs. While enforcement costs will need to be funded, other programs will not be sustained if revenues are reduced in the next three to five years due to oversupply of cannabis in the market and a reduction in price. Until the market stabilizes in the next three to five years, revenues should be allocated in part to one-time needs and prudence exercised for ongoing programs.

**Staff Recommendation:** Staff recommends a General purpose tax measure be developed for the June 2018 ballot. However, if a Special Tax measure is approved by the Board, staff recommends conceptual direction and staff will return for a more specific final list on January 23, 2018.

Further, staff recommends incorporating the items of Board consensus direction #1-9 listed above, provided by the Board on December 14, 2017, be included as needed. Staff recommends that the tax measure be brought back on January 30, 2018 for Board approval.

### **Cannabis Banking, Treasury and Accounting Issues**

On December 14, 2017, staff provided the Board with a general overview of issues related to cannabis banking including restrictions placed on banking for cannabis operations and the uncertainty of whether past federal administrative policies and prosecutorial priorities will continue into the future. Staff also provided an overview of a report from the Cannabis Banking Working Group convened by State Treasurer John Chiang including the difficulty of handling cash payments safely and effectively.

At the December meeting, the Board requested hearing from the the Treasurer Tax Collector as to the mechanics of how the cannabis tax would be collected. Staff has proposed a quarterly collection, at a minimum. Treasurer Tax Collector representatives will be available to provide input on the process.

Since December 14th, additional discussions occurred with the Treasurer-Tax-Collector, County Executive Office staff, County Counsel as well as with the Auditor-Controller. The Board should be aware of additional local concerns, including:

- County Treasurer-Tax Collector reports that, concerning the potential regulation and taxation of cannabis by the Board of Supervisors, Treasurer-Tax Collector:
  - Does not yet have a commitment from a financial institution that would accept cannabis-sourced tax, license and permit revenues from the County;
  - Would plan to segregate cannabis-sourced revenues and expenditures from other funds held for the County and other depositors, including for school districts and special districts;
  - Recommends that the Board of Supervisors receive additional information and then consider the potential benefits from not receiving cannabis-sourced permit or license fees and offsetting this with receiving only cannabis-sourced tax revenues, which could be set slightly higher to offset for the deletion of cannabis-sourced permit and license fees.

On this last point, the CEO does not recommend this approach. The County's current practice and policy has been to collect appropriate fees for services rendered, to the extent allowed by law. Should the Board proceed to implement this last recommendation of the Treasurer-Tax Collector, the CEO cautions:

- No funding would be available to replace fee revenue to establish a permit, licensing and compliance program until a tax measure is possibly approved by the voters. This cost was estimated at approximately \$2.5 million for Fiscal Year 2018-19. There would be no available source of new funds for this work, unless the Board chose to reduce funding to other departments; and
- The tax rates would need to be approximately 20 to 25% greater than the proposed tax rates listed earlier in this Board Letter.

The Auditor-Controller's concern is that the County's existing financial and accounting infrastructure is designed around one central bank account. Segregating multiple cannabis sourced revenues into a separate bank account with a different financial institution and disbursing funds from that account will require significant changes to, and/or duplication of, the County's banking processes, accounting processes, accounting systems, and internal controls. While the full extent of the impacts is not presently known, major processes impacted include, but are not limited to:

- Treasury deposits;
- Interest apportionments;
- Monthly reconciliations;
- Property tax collections and distributions;
- Expenditure disbursements;
- Financial reporting and fund structure; and

- Impacts on mandatory participants in the investment pool.

Changes to property tax collection and distribution processes to isolate cannabis sourced revenues will not only impact the County, but also other local governments including schools, community colleges, and special districts.

Staff is evaluating ways to minimize these impacts with specific modifications of the County’s accounting infrastructure should a financial institution that will accept deposits of monies derived from cannabis activities be identified.

As to other options, County Executive Office staff contacted the Deputy Treasurer for Public Finance in the Office of State Treasurer John Chiang. Deputy Treasurer Schafer stated that he was unaware of another jurisdiction (local or other states) that was segregating cannabis tax and fee revenue from their general revenues. The State of California has developed a statewide system with armored car pick up of tax receipt at State licensed cannabis operations. The armored car services will bring it to the company’s location for counting and the creation of a deposit slip. The tax revenue is then driven to the nearest Federal Reserve Bank (main bank is in San Francisco with a branch in Los Angeles) where the cash is deposited and then transmitted through the Automated Clearing House (ACH) network to our County’s bank for depositing.

**Performance Measure:**

N.A.

**Contract Renewals and Performance Outcomes:**

N.A.

**Fiscal and Facilities Impacts:**

**Budgeted:** Yes, as to staff time. There will be additional fiscal impacts depending on directions provided by the Board. **Fiscal Analysis:**

<b><u>Funding Sources</u></b>	<b><u>Current FY Cost:</u></b>	<b><u>Annualized On-going Cost:</u></b>	<b><u>Total One-Time Project Cost</u></b>
General Fund			
State			
Federal			
Fees			
Other:			
Total	\$ -	\$ -	\$ -

**Narrative:** Staff time and contracted services to support the development of possible regulations of cannabis operations in unincorporated Santa Barbara County is included in the Fiscal Year 2017-18 Adopted Budget.

**Key Contract Risks:**

N.A.

**Staffing Impacts:**

**Legal Positions:**

**FTEs:**

None at this time.

**Special Instructions:**

**Attachments:**

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**CC:**

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Theo Fallati, Auditor-Controller  
Michael Ghizzoni, County Counsel