



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: June 18, 2024: 1st Reading
Placement: Departmental
Estimated Time: 45 min
Continued Item: No
If Yes, date from:
Vote Required: 4/5

TO: Board of Supervisors
FROM: Department: Mona Miyasato, County Executive Officer
Director(s)
Contact Info: Nancy Anderson, Chief Assistant County Executive Officer
Brittany Odermann, Deputy County Executive Officer

DocuSigned by:
Mona Miyasato
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SUBJECT: Amendments to the Tax on Cannabis Operations Ordinance

County Counsel Concurrence

Treasurer-Tax Collector Concurrence

As to form: Yes

As to form: Yes

Recommended Actions:

That the Board of Supervisors consider the following actions:

- a) Consider the introduction (First Reading) of an ordinance of the Board of Supervisors of the County of Santa Barbara amending Chapter 50A, "Tax on Cannabis Operations" of the Santa Barbara County Code to change the tax on cannabis cultivation in the unincorporated area of the County ("Ordinance"):
 - 1. **Option 1** (Attachment A) proposes a tax on cannabis cultivation computed as follows:

Cultivation: Four percent of gross receipts or based on square footage for licenses having taxable transfer activity in the reporting period, whichever is greater

 - i. *The rate for non-outdoor cultivation shall be a maximum of two dollars and fifty cents (\$2.50) per quarter, per square foot, with an initial rate set at twenty-five cents (\$0.25) per quarter, per square foot;*
 - ii. *The rate for outdoor cultivation shall be a maximum of seventy-five cents (\$0.75) per quarter, per square foot, with an initial rate set at two and a half cents (\$0.025) per quarter, per square foot; **or***
 - 2. **Option 2** (Attachment C) proposes a tax on cannabis cultivation computed as follows:

Cultivation: Four percent of gross receipts or based on square footage for licenses having taxable transfer activity in the reporting period, whichever is greater

- i. The rate for non-outdoor cultivation shall be a maximum of two dollars and fifty cents (\$2.50) per quarter, per square foot, with an initial rate set at fifty cents (\$0.50) per quarter, per square foot;*
- ii. The rate for outdoor cultivation shall be a maximum of seventy-five cents (\$0.75) per quarter, per square foot, with an initial rate set at ten cents (\$0.10) per quarter, per square foot;*
- b) Read the title, “An Ordinance Amending Chapter 50A, Tax on Cannabis Operations, of the Santa Barbara County Code,” and waive further reading of the Ordinance in full;
- c) Appoint and authorize member(s) of the Board of Supervisors to author, sign, and submit on behalf of the Board an argument in favor of the ordinance amending Chapter 50A, “Tax on Cannabis Operations” ballot measure and any rebuttal;
- d) Provide other direction as appropriate; and
- e) Set a hearing on the Agenda of July 9, 2024 to consider the following actions:

On July 9, 2024:

- a) Consider adoption (Second Reading) of an ordinance of the Board of Supervisors of the County of Santa Barbara amending Chapter 50A, “Tax on Cannabis Operations” of the Santa Barbara County Code to change the tax on cannabis cultivation in the unincorporated area of the County (“Ordinance”); and
- b) Adopt a Resolution submitting the proposed Ordinance and ballot language to change the tax on cannabis cultivation to the electorate for approval, and requesting and ordering consolidation with the November 5, 2024 General Election; and
- c) Determine that the above actions are not a project under the California Environmental Quality Act (CEQA) pursuant to Section 15378(b)(4) of the CEQA Guidelines because they consist of the creation of government funding mechanisms which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment.

Summary:

On May 14, 2024, the Board directed staff to return on June 18th with proposed ordinance language to amend Chapter 50A, “Tax on Cannabis Operations,” changing the way cannabis cultivation activities are taxed. The proposed ordinance amendment includes a hybrid structure that incorporates a minimum activity tax rate based on transfers within the State’s track-and-trace system (Metrc) and permits the Board to adjust these rates up to a designated maximum no more than every two years and by a four-fifths vote. Since the May 14 meeting, staff determined the need for clarification on how the rate is applied that has resulted in two options for ordinance amendments. Option 1 proposes initial square footage rates of two and half cents (outdoor) and twenty-five cents (non-outdoor) applied **quarterly**, equating to ten cents per square foot (outdoor) and one dollar per square foot (non-outdoor) if applied annually, per Board direction (Attachment A). Option 2 proposes alternative square footage rates of ten cents (outdoor) and fifty cents (non-outdoor) applied **quarterly** (Attachment C). Board approval of one of these options will initiate the process to place the changes on the November general election ballot. Staff recommends Option 2 as discussed below.

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Discussion

At the May 14, 2024 board hearing, staff presented two methodologies for changing the cannabis cultivation tax. The Board directed staff to return with proposed ordinance language to amend Chapter 50A, “Tax on Cannabis Operations,” and that the proposed ordinance language include the following:

- hybrid structure of gross receipts tax rate with a minimum activity tax rate based on State licensed square footage;
- apply activity rate to licensed square footage where activity occurs, defined as transfers;
- set initial activity rate at 10 cents outdoor and \$1.00 non-outdoor;
- set a maximum activity rate at 75 cents outdoor and \$2.50 non-outdoor; and
- limit Board action to change rates to once every 2 years following implementation by 4/5 vote.

In the hybrid model option, cultivators would be assessed the greater of the square foot tax based on State licensed area with activity, i.e. transfers, or the current 4% gross receipts tax. If the square footage calculation is less than gross receipts; the operator pays gross receipts tax.

Clarification of Quarterly versus Annual Square Footage Rates.

Since the current gross receipts model is reported and assessed quarterly; the square footage rate and model would need to apply quarterly as well to facilitate the comparison between which of the two payment options is greater, and therefore how much tax is owed. Implementing an annual process now would be challenging and difficult to administer. The following discussion addresses this need to apply quarterly rates and how that affects revenue collections.

Option 1: Ten cents (outdoor) and \$1.00 (non-outdoor) initial rates (if applied *annually*).

The Board directed initial square footage activity rates for each of the cultivation types shown in Table 1. below.

Table 1. Board Directed Initial Activity Rates (Annual)

Cultivation Type	Initial Activity Rate per SF
Outdoor	\$0.10
Non-outdoor	\$1.00

The Board discussion did not include whether the rates were to be adjusted for quarterly implementation. When the initial rates in Table 1. are adjusted for quarterly implementation, the effective rates are shown in Table 2.

Table 2. Board Directed Initial Activity Rates (per Quarter)

Cultivation Type	Initial Activity Rate per SF
Outdoor	\$0.025
Non-outdoor	\$0.25

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Staff feels these rates may be too low and not consistent with the Board’s intent as discussed at the May 14, 2024 hearing. Following the hearing, Treasurer-Tax Collector (TTC) staff performed analysis on the proposed rates using local average pricing data and taxable transfer activity in the current fiscal year. The intent was to ensure that the proposed initial activity rates address the issues of underreporting by some operators, and achieve more parity in tax revenue between operations and cultivation types based on current pricing data. Staff reviewed active state licenses in the first three quarters of fiscal year 2023-24 and calculated average pricing data as reported by the operators. The analysis determined that the proposed initial rates may be too low to address underreporting and parity among operators.

However, staff prepared the ordinance amendment language to reflect the Board’s direction, with rates shown in Table 2. These numbers are reflected in the proposed amended ordinance language Option 1, Attachment A.

Option 2: Ten cents (outdoor) and fifty cents (non-outdoor) initial rates applied quarterly

Based on the TTC’s analysis, a better quarterly rate proposal to address underreporting and parity among operators is shown in Table 3. The analysis found that conservative average quarterly activity rates equate to the following:

Table 3. Average Pricing Equivalent Activity Rates (per Quarter)

Cultivation Type	Proposed Activity Rate per SF
Outdoor	\$0.10
Non-Outdoor	\$0.50

As shown, the proposed outdoor rate of \$0.10 per square foot is reasonable when applied as an activity rate even when done so quarterly since cultivation is seasonal and activity limited throughout the year. For non-outdoor operations, which typically cultivate and transfer product year-round, a quarterly rate of \$0.50 represents a more reasonable value while still capturing any outliers that have reported below market values.

Additionally, at the May 14th meeting staff reported that the current split of tax revenue generated between the outdoor and non-outdoor is 30% to 70%. Using the board directed rates, the estimated share would continue at 30% outdoor/70% non-outdoor. The rates in Table 3 are estimated to bring that share to 40% outdoor/60% non-outdoor. These rates, applied quarterly, are estimated to produce a more equitable system for both cultivation types. The average pricing equivalent activity rates in Table 3 are proposed for Board consideration and reflected in the proposed amended ordinance language, Option 2, Attachment C.

Determination of When Activity Occurs in determining “Initial Activity Rates”

Activity is considered to occur when a taxable transfer has been made. A taxable transfer occurs when transfers take place from County licenses (or activities) to any other licenses (or activities) i.e. nursery, distributor, cultivation, manufacturing, retail, and microbusiness. To generate the square footage tax amount, the initial activity rate is applied to the State license square footage where taxable transfers have been made.

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Staffing Considerations

Current staffing in the Treasurer-Tax Collector's office for cannabis tax compliance includes one senior level manager and a senior finance office professional. Initial review of staffing and the workload associated with maintaining the current tax structure, reporting and auditing gross receipts, in addition to the review and billing needed to implement the square footage component of the hybrid model, warrants at least one additional staff person that can perform analytics. The estimated cost of this additional staff is approximately \$175,000 per year. Cannabis fees or tax revenues could be used to pay for this position beginning in fiscal year 2025-26.

Maximum rates. The Board chose the following maximum activity rates for each of the cultivation types. Per the discussion above, staff prepared the ordinance amendment with these maximum activity rates applying *quarterly*.

Table 4. Board Directed Maximum Activity Rates

Cultivation Type	Maximum Activity Rate per SF (Quarterly)
Outdoor	\$0.75
Non-outdoor	\$2.50

Method for adjustments to rates. The Board directed staff to include language that would limit the ability to adjust tax rates by constraining the adjustments to once every two years and with a four-fifths vote of the Board. The four-fifths vote requirement is permissible but it may be amended or repealed by a majority vote of the board of supervisors at any time.

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Table 5. Proposed Amendments to Tax on Cannabis Operations Ordinance

Board Direction	Proposed Amendment	County Code Section
Develop hybrid structure of gross receipts tax rate with a minimum activity tax rate based on State licensed square footage	Add language under the Cultivation activity tax that includes the consideration of a square foot rate in addition to gross receipts; whichever is greater	County Code § 50A-1(a)(4)
Apply activity rate to licensed square footage where activity occurs, defined as transfers	Add clarifying language that defines taxable transfers and how the activity rate is applied	County Code § 50A-1(a)
Set initial activity rate at 10 cents outdoor and \$1.00 non-outdoor	Option 1: Add subsections under the cultivation activity tax that sets the initial quarterly rates for non-outdoor and outdoor cultivation at \$0.25 and \$0.025 cents, respectively. Option 2: Add subsections under the cultivation activity tax that sets the initial quarterly rates for non-outdoor and outdoor cultivation at \$0.50 and \$0.10 cents, respectively.	County Code § 50A-1(a)(4)i-ii.
Set a maximum activity rate at 75 cents outdoor and \$2.50 non-outdoor	Add subsections under the cultivation activity tax that designate maximum rates for non-outdoor and outdoor cultivation	County Code § 50A-1(a)(4)i-ii.
Limit Board action to change rates to once every 2 years following implementation by 4/5 vote	Add language that limits how and when cultivation tax rates can be adjusted	County Code § 50A-1(b)

Ancillary Issue	Proposed Amendment	County Code Section
New Definitions	Include additional and revised definitions as needed to implement proposed changes	County Code § 50A-2
Transactions and pricing	Add section to clarify that gross receipts are based on product transfers at fair market value	County Code § 50A-3(b)
Include square footage tax	Add “square footage tax” for due dates and delinquencies	County Code § 50A-5

The specific amended Chapter 50A sections are provided for Option 1 in Attachments A and B and for Option 2 in Attachments C and D.

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Tax Payment Reporting and Auditing

County staff continue to work with operators to ensure consistency in reporting taxable transfers and calculating taxes due based on realistic market pricing. Currently, TTC staff are working with operators individually to understand their business models, product type(s), and movement through the supply chain to provide guidance on accurate reporting and tax payment.

Staff in the Treasurer-Tax Collector's (TTC) Office compiles quarterly analyses of the Metrc transfers and works directly with operators to communicate reporting expectations. This communication has resulted in the continued decrease of non-reporting and reporting unit discrepancies, allowing the tax reporting process to make forward progress. When discrepancies do occur, their office works with the operators and requires revised quarterly reports to be submitted as part of tax compliance.

In 2022 the TTC's office engaged consultant Hinderliter, de Lamas & Associates (HdL) for financial review on a select number of cannabis operations. More comprehensive work was not possible at that time because of deficiencies in information reported. Since that time, however, changes were implemented that has resulted in improvements in information collected and reported, allowing HdL to perform cannabis business tax audits.

According to HdL, the first round of comprehensive audits is estimated to be complete by the end of July 2024. Only two are being completed at this time to serve as models for future audits but are comprehensive where HdL conducts "a risk-based review of each business using the proprietary Cannabis Analytical Tracking Solution (CATS™). CATS allows audit staff to cross-analyze multiple business records to identify reporting variances, discrepancies and outliers to produce the most accurate measure of gross receipts on behalf of the County." The County could expand the scope after these initial audits to include more operators, using HdL or other qualified service providers. Alternatively, the Board could consider adding staff to the TTC office to perform the work. After the first round of audits are completed, staff will work with the TTC to assess the scope, costs and schedule of future audits, and can include this discussion in the fourth quarter cannabis update report. Staff will also explore if and how these costs can be recovered in the compliance licensing fees and, if so, update those fees as appropriate.

Background:

The ability for the County to levy a Cannabis Operations Tax is provided under the California Revenue and Taxation Code Section 34021.5(a)(1). On February 13, 2018, the Board adopted Ordinance No. 5026 adding Chapter 50A to the Santa Barbara County Code, "Tax on Cannabis Operations." In June 2018, the voters approved a measure establishing a general tax on cannabis operations. The current tax structure is based on the gross receipts of each operation's activities involving cannabis or cannabis products and was developed with assistance from consultant Hinderliter, de Lamas & Associates (HdL) using information they provided to the Board on [December 14, 2017](#).

At the time, the Board was presented taxation options, including a tax on gross receipts, square footage and per unit/ounce. When making its decision on the tax structure, the Board considered several factors: stability of tax revenue streams; complexity of tax structure and compliance; potential to inadvertently keep businesses in the unregulated market if the local and state tax burden was too great; and methods for tax rate adjustments.

The current tax is computed as follows:

1. Nursery: One percent of gross receipts; and
2. Distributor: One percent of gross receipts; and
3. Manufacturing: Three percent of gross receipts; and

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4. Cultivation: Four percent of gross receipts; and
5. Retail: Six percent of gross receipts; and
6. Microbusiness: Six percent of gross receipts.

On May 17, 2022, the Board reviewed the tax structure and discussed various options, including a tax by square footage or hybrid options. At that time, without a standard, indexed commodity price of cannabis, however, the conclusion was that pricing of the product would be difficult, and the Board opted to not change the gross receipt structure but instead seek to improve auditing methods. Based on the direction, TTC staff contracted for additional financial monitoring audits with consultant Hinderliter, de Lamas & Associates (HdL) on a select number of cannabis operations.

Again, on May 14, 2024, the Board considered two cannabis cultivation taxation methodologies. The Board directed staff to return with the hybrid tax model for a potential ballot measure in November 2024.

Fiscal Analysis:

Using the current fiscal year data from the first three quarters, TTC staff estimated the amount of tax that would be generated using the proposed hybrid tax model with the quarterly rates shown above in Tables 2&3.

	2023 - 2024 Current Tax (Q1-Q3)	Option 1 Estimated Hybrid Tax (\$0.025 and \$0.25)*	Option 1 Difference	Option 2 Estimated Hybrid Tax (\$0.10 and \$0.50)*	Option 2 Difference
Non-Outdoor	\$ 2,882,933	\$ 3,168,573	\$ 285,640	\$ 3,528,796	\$ 645,863
Outdoor	\$ 1,125,156	\$ 1,242,855	\$ 117,699	\$ 2,223,369	\$ 1,098,213
	\$ 4,008,089	\$ 4,411,427	\$ 403,339	\$ 5,752,165	\$ 1,744,076

* Estimated hybrid tax amount was based on taxable transfers that occurred during July 2023 – March 2024. Future taxable transfers are dependent upon operation’s state licenses and structure; therefore, future taxes may not reflect historical data.

Additional staffing costs to successfully implement and administer the hybrid model are estimated to be \$175,000 annually.

Special Instructions:

The Clerk of the Board is requested to publish notice of the ordinance in accordance with Government Code section 25124.

Attachments:

- Attachment A - Option 1: Tax on Cannabis Operations Ordinance Amendment **(Non-Redlined)**
- Attachment B - Option 1: Tax on Cannabis Operations Ordinance Amendment **(Redlined)**
- Attachment C - Option 2: Tax on Cannabis Operations Ordinance Amendment **(Non-Redlined)**
- Attachment D - Option 2: Tax on Cannabis Operations Ordinance Amendment **(Redlined)**

Authored By:

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