



COUNTY OF HUMBOLDT

For the meeting of: 2/1/2022

File #: 22-87

To: Board of Supervisors

From: County Administrative Office

Agenda Section: Departmental

SUBJECT:

Recommendation For the Board to Consider Implementation of a Cannabis Excise Tax Suspension/Waiver Program for Tax Year 2021 (collected in 2022) and Tax Year 2022 (collected in 2023)

RECOMMENDATION(S):

That the Board of Supervisors:

1. Direct the County Administrative Office (CAO) to develop a Cannabis Excise Tax Suspension /Waiver program for Tax Year 2021 (collected in 2022) and Tax Year 2022 (collected in 2023) and bring back to the Board for final review and approval a resolution establishing and documenting the program; and
2. Provide additional direction as needed.

SOURCE OF FUNDING:

Measure S Cannabis Excise Tax - General Fund (1100)

DISCUSSION:

This report seeks Board direction and possible action to create a Cannabis Excise Tax Suspension/Waiver program for Tax Year 2021 and 2022, billed and collected a year in arrears for calendar year 2022 and 2023. This recommendation is a continued response to the current state of the cannabis industry which is experiencing unsustainably low market pricing and an inability to sell existing cannabis inventory. Many cultivators have voiced concern that they will not survive current conditions. The Cannabis Ad Hoc Committee is concerned about the long-term viability of the Humboldt County cannabis industry, particularly those smaller farms who may have fewer financial resources. The county has provided significant resources and accommodations to support the cannabis industry (See Attachment 1).

In order to create immediate relief, the Cannabis Ad Hoc Committee met to discuss possible solutions to assist the cannabis cultivation community with excise tax relief. Proposed is a Tax Suspension/Waiver program that would allow cultivators to request or opt-in to the program and delay payment of the tax year 2021 and 2022 excise taxes until calendar year 2024. Under the proposed

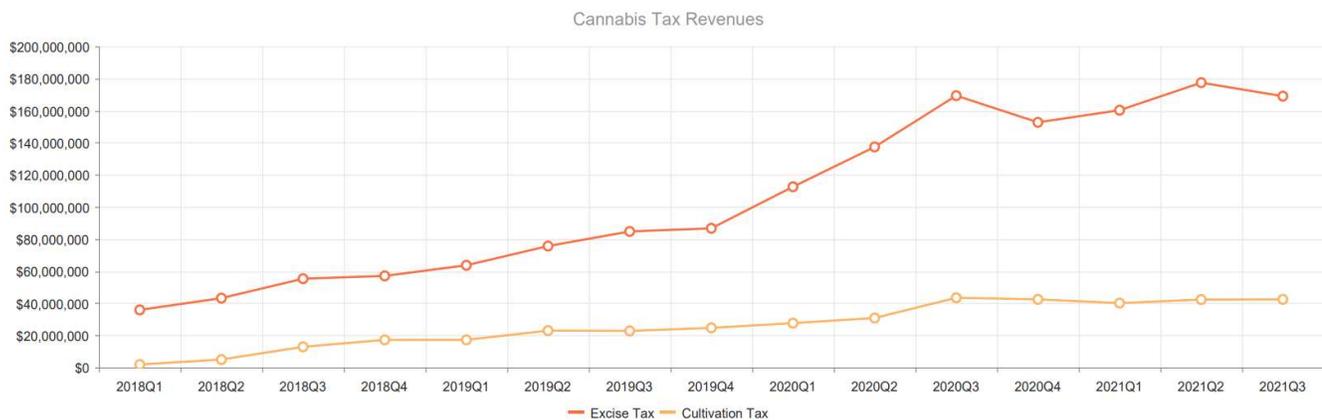
program, qualifying cultivators would be able to apply for a partial or complete waiver of two years excise taxes based on need and actual profit or losses incurred for tax year 2021 and 2022. Outstanding excise taxes not forgiven could be repaid without penalties. Staff will further explore the option of offering repayment plans. However, repayment options need additional research to ensure it meets legal and system constraints.

This report seeks direction from your Board on whether staff should develop a program based on the outline discussed above, another approach - as detailed below, or take other action.

State and County Cannabis Cultivation Taxes

Taxes at both the [state <https://www.cdtfa.ca.gov/industry/cannabis.htm>](https://www.cdtfa.ca.gov/industry/cannabis.htm) and local level are, in part, contributing to the market instability and inability of local cultivators to sell their crops at prices that cover costs - including taxes and other state and local fees and charges. Although still an added expense, Humboldt County's cultivation excise tax burden is significantly less than the state cultivation tax burden. The county cultivation tax is billed at the beginning of the calendar year by the Treasurer Tax Collector for the prior calendar year's cultivation activity, with the first installment generally due by Mar. 15 and the second installment due by Oct. 15. In Humboldt, a cultivator's tax responsibility is determined by the area actually used to cultivate, which is typically the area defined on their permit. Cultivators may submit documentation to the Planning & Building Department to reduce the amount of square footage the permit holder plans to cultivate or actually cultivated for the year. Cultivators have some flexibility in determining the amount of the tax owed at both the state and local level, however the strain of paying both taxes has put pressure on the local industry.

The state imposes a cannabis excise tax of 15% on retail purchases of cannabis or cannabis products. The state also imposes a cultivation tax, which as of Jan. 1, 2022, is [">\\$161 a pound for cannabis flower \(or \\$10.08 per dry-weight ounce <https://www.cdtfa.ca.gov/taxes-and-fees/tax-rates-stfd.htm>](https://www.cdtfa.ca.gov/taxes-and-fees/tax-rates-stfd.htm)). At the state level, the cultivation tax is paid by the cultivator to the distributor or manufacturer when the cannabis product enters the legal commercial market. For third quarter of 2021 (most recently available data), cannabis retail excise tax revenues declined, and cultivation taxes were relatively flat.



Source: [<https://www.cdtfa.ca.gov/dataportal/charts.htm?url=CannabisTaxRevenues>](https://www.cdtfa.ca.gov/dataportal/charts.htm?url=CannabisTaxRevenues)

Because the state cultivation tax is calculated on weight of the cultivation product placed in the legal commercial market and Humboldt County Cannabis tax is based on the square footage of the cultivation area, comparing fees is an apples to oranges evaluation. Humboldt County excise tax is currently \$1.084 per square foot of growing space (canopy) for outdoor light, \$2.169 for mixed light and \$3.255 for indoor light.

The state’s tax is not only dependent upon the yield of plants, but also how much product actually enters the legal market. A [2013 study \(BOTEC\) <https://lcb.wa.gov/publications/Marijuana/BOTEC%20reports/5a_Cannabis_Yields-Final.pdf>](https://lcb.wa.gov/publications/Marijuana/BOTEC%20reports/5a_Cannabis_Yields-Final.pdf) commissioned by the State of Washington Liquor and Cannabis Board states that the average yield for its study was 40 grams per square foot, although that figure varies depending on many factors. Assuming a yield on 5,000 sq ft of 40 grams per sq ft for a single crop per year the state cultivation tax will total \$71,114 (5,000*40 grams = 200,000 grams or 7,144 ounces * \$10.08). Assuming a lower yield, 5,000 sq ft yielding 20 grams per sq ft for one crop per year will generate state cultivation tax of \$35,556 (5,000*20 grams = 100,000 grams or 3,527 ounces * \$10.08). The chart below shows those comparisons.

Estimated Cultivation Tax Obligation Based on BOTEC Analysis Report			
	Outdoor	Mixed Light	Indoor
County Tax 5,000 Sq Ft	\$5,375	\$10,750	\$16,275
State Tax 5,000 Sq Ft	\$71,114	\$71,114	\$71,114
40 grams per Sq Ft			
Ratio County vs State	7%-93%	13%-87%	19%-81%
State Tax 5,000 Sq Ft	\$35,556	\$35,556	\$35,556
20 grams per Sq Ft			
Ratio County vs State	13% - 87%	23% - 77%	31% - 69%

**State tax estimates above assume only one harvest per year for each grow category, additional harvests would increase the state tax but not the county cultivation tax.*

These simple calculations do not account for lost crops, less dense cultivation, product not sold on the legal market, or multiple crops per year using the same canopy or square footage. The result is that the state tax can vary greatly based on different circumstances. Excluding the decision to not cultivate or to cultivate a smaller farm, the county tax remains the same, regardless of the harvested yield produced on the land.

Response at the State Level

There has been some attention at the state level to the industry challenges. Feedback from a recent [rally in Sacramento <https://www.times-standard.com/2022/01/13/this-is-an-extinction-event-cannabis-stakeholders-rally-for-action-in-sacramento/?fbclid=IwAR3bzSUIRqkXrniO-pphHwAxRs_oM6SDqyo41zHjlmRSJapla_HUUIYakMM>](https://www.times-standard.com/2022/01/13/this-is-an-extinction-event-cannabis-stakeholders-rally-for-action-in-sacramento/?fbclid=IwAR3bzSUIRqkXrniO-pphHwAxRs_oM6SDqyo41zHjlmRSJapla_HUUIYakMM) with Humboldt County representation indicated that Governor Newsom’s office is receptive to state relief. The issue has also been communicated to elected legislators, Assemblymember Jim Wood and Senator Mike McGuire, who both indicated a willingness to sponsor legislation to provide relief to the legal cannabis industry.

The California Cannabis Industry Association has also created outreach for its partners to request elimination of the state cultivation tax, reform of the cannabis tax collection system, expansion of state-wide access to legal cannabis retail, and greater accountability of the Department of Cannabis Control. Investment in these advocacy efforts could result in significant sustainable relief for the cannabis cultivators. Without relief at the state level, the entire burden for relief for the cultivators falls on the county and its residents. This burden should not fall entirely on the county and for relief to be effective it will require changes and concessions from the state system.

Humboldt County Cannabis Cultivators

A portion of the discussion from the Cannabis Ad Hoc Committee was about the financial wherewithal of the smaller permitted farms. The following tables provide the demographics of the cannabis cultivation permits for Humboldt County as of Dec. 20, 2021.

Size of Farm	# Of Permitted Cultivators*	% Of Cultivators	Total Square Footage*	% Of Total Square Footage
≤ 5,000 Sq Ft	190	21%	701,852	5%
5,001 - 10,000 Sq Ft	367	40%	3,285,460	23%
10,001 - ≤ acre (43,560 Sq Ft)	337	37%	7,685,079	56%
> 1 acre	20	2%	2,692,260	16%
Total	914	100%	14,364,651	100%

**Reported figures from cultivation permits issued as of December 20, 2021 (All Approved Cannabis)*

Small farms at or under 5,000 sq ft make up 21% of the permitted cultivators but only account for 5% of the cultivated land. Whereas farms that are larger than 1 acre, are just 2% of the cultivators but account for 16% of the cultivated land. Farms of 10,000 sq ft or less account for 61% of the cultivators but just 28% of the cultivated land. If your Board determines that there is a greater need to reduce Measure S taxes for smaller farms (10,000 sq ft or less), the impact to the county’s Measure S revenues would be significantly lower than a tax waiver applied to all farms.

Something else for the Board to keep in mind is the percent of cultivation in each cost category. As shown in the chart below, outdoor grows account for 73% of the cultivated land in the county.

Outdoor Light	Mixed Light	Indoor Light
73% of Total Sq Ft	26% of Total Sq Ft	1.0% of Total Sq Ft
\$1.084 per Square Foot	\$2.169 per Square Foot	\$3.255 per Square Foot

FINANCIAL IMPACT:

It is difficult to determine the financial impact of creating a tax suspension/waiver program because of the unknown number of cultivators who will request the waiver and qualify for suspension or reduction of the tax over the two-year period. Consolidation and cultivators going out of business will also have an impact on the cultivation excise tax revenues. The chart below provides an annual summary of historic Measure S cannabis tax bills versus collections.

Historic Measure S Tax Collections				
	2017	2018	2019	2020*
# Of Bills Mailed**	411	1,297	1,081	1,164
Tax \$ Billed	\$5.3 million	\$19.3 million	\$20.9 million	\$19.4 million
Tax \$ Collected	\$5.0 million	\$17.5 million	\$17.5 million	\$10.3 million
Tax \$ Owed	\$300k	\$2.2 million	\$3.4 million	\$9.1 million
Delinquency Rate	6%	11%	16%	47%

**Board directed the Treasurer-Tax Collector to not assess fees for late payment of taxes due in Oc 2022, if paid in full by May 31, 2022. **The number of bills and the number of permitted cultivators different times and calculated on different metrics.*

As noted, Measure S is collected a year in arrears based on a calendar year not the county’s July 1 to June 30 Fiscal Year (FY). For FY 2021-22, the county estimated cannabis excise tax revenue of \$9.2 million. The decrease in revenue from FY 20-21, was in anticipation of refunds associated with the recent litigation based on the cultivation square footage calculations and resulting changes to how the tax would be calculated going forward. As of Dec. 31, 2021, only \$2.3 million has been collected, compared the \$6.8 million as of Dec. 31, 2020. The nearly 300% decrease in revenue collections is an indicator of the struggling cannabis market and provides some indication of how many cultivators would participate in the suspension/waiver program. Only 41% of cultivators paid their excise tax assessments in full for tax year 2020.

If 60% of cultivators participate in the suspension/waiver program, at best this means a delay of nearly \$12 million (60% of \$19 million) per year or a total of \$24 million until calendar year 2024, when the funds would either be waived, waived in part, or if legally viable paid over some period going forward.

A \$12 million annual reduction in the Measure S funds will have a significant impact on the county’s General Fund, particularly with the recent salary adjustments to make staff salaries more competitive and commensurate with market value. The preliminary estimate for county General Fund payroll for FY 2022-23, excluding overtime, is \$107 million. This includes 135 vacant positions, which equates to an estimated 17% vacancy rate.

Fiscal Impact Summary

Any reduction or waiver of taxes will impact the county’s ability to provide services and will require budget reductions. A reduction in revenues this significant would require staff to evaluate cost-saving measures such as:

1. Hiring Freeze. Based on preliminary estimates, an immediate hiring freeze for General Fund positions, could reduce the FY 2022-23 Projected Budget by an estimated \$18 million, if the hiring freeze is in place for the full fiscal year.
2. Workforce Reductions. A more calculated and permanent workforce reduction program, such as layoffs, could be developed to respond to the reduced tax revenues in the General Fund.

3. Program/Department Budget Reductions. During budget preparation for FY 2022-23, the Board could consider specific programs, services, departments, and allocations to reduce to respond to the revenue reduction, particularly those that are directly funded by Measure S, such as Project Trellis.

Under the proposed suspension waiver scenario, there will be two significant indicators to measure in the next six months. The first is how many cultivators pay the 2020 taxes due by May 31, 2022, and how many request a waiver of the 2021 taxes which are scheduled for billing within the next several weeks.

STRATEGIC FRAMEWORK:

This action supports your Board's Strategic Framework by engaging in discussions of our regional economic future.

OTHER AGENCY INVOLVEMENT:

Treasurer Tax Collector
Economic Development
Planning and Building Department

ALTERNATIVE RECOMMENDATIONS:

The Board can choose to give direction to act on the item above or consider the following alternative measure. Attachment 5 provides a discussion of additional alternatives and the estimated fiscal impact of all alternative recommendations.

A. Provide tax reduction/suspension to small (10,000 sq ft or less) outdoor cultivation farms, who have reportedly been impacted to a greater extent by the drop in market pricing and who over the long-term operate a more environmentally sustainable business model. Outdoor grown cannabis is currently not in favor with the retail market and as a result the price per pound is less than the indoor grown cannabis product. Farmers raising sun-grown cannabis typically grow fewer plants and have a limited number of harvests during the year, as a result a lower price per pound is of greater impact to their financial well-being. This alternative also focuses on the small local farmers, who are more likely to have struggled with historical inequities and the transition from the illegal to legal cannabis marketplace. It is also in line with the county's investment in environmentally responsible cannabis businesses.

Limiting assistance to small outdoor growers will have less impact on the county's Measure S revenues than the recommendation outlined at the beginning of the staff report and would conserve funding that could be used for other forms of support for the Humboldt County cannabis industry as the cannabis market continues to evolve.

The CAO recommends this alternative, which would reduce Measure S revenue by \$3 million or approximately 30%.

	≤ 5,000 Sq Ft	5,001-10,000 Sq Ft	10,001-≤ 1 Acre (43,560 Sq Ft)	> 1 Acre	Totals
Total Current Revenue	\$ 1,030,866	\$ 4,663,338	\$ 10,251,267	\$ 3,954,615	\$ 19,900,087
Waive 100% for Small Sun-Grown (≤10,000 Sq Ft) Revised Revenue	\$ 483,654	\$ 2,190,111	\$ 10,251,267	\$ 3,954,615	\$ 16,879,648
Reduction	\$ 547,212	\$ 2,473,227	\$ -	\$ -	\$ 3,020,439

ATTACHMENTS:

1. Cultivator Support
2. Other California Counties' Response to Cannabis Cultivation Taxes
3. Humboldt County Measure S
4. Summary Measure S Appropriations FY 2018-2021
5. Financial Impacts for Alternative Recommendations

PREVIOUS ACTION/REFERRAL:

Board Order No.: N/A

Meeting of: N/A

File No.: N/A