



# COUNTY OF SAN DIEGO

## AGENDA ITEM

### BOARD OF SUPERVISORS

NORA VARGAS  
First District

JOEL ANDERSON  
Second District

TERRA LAWSON-REMER  
Third District

NATHAN FLETCHER  
Fourth District

JIM DESMOND  
Fifth District

**DATE:** January 24, 2023 and February 28, 2023

# 10

**TO:** Board of Supervisors

### SUBJECT

**CONSIDERATION AND ADOPTION OF AN ORDINANCE TO SET RATES FOR THE VOTER APPROVED CANNABIS BUSINESS TAX (1/24/2023 – First Reading; 2/28/2023 – Second Reading, unless ordinance is modified on Second Reading) (DISTRICTS: ALL)**

### OVERVIEW

On January 27, 2021 (4), the Board of Supervisors (Board) directed the Chief Administrative Officer (CAO) to explore the implementation of a commercial cannabis ordinance, regulations, and programs with a social equity component for the unincorporated area, including the development and implementation of a commercial cannabis taxation program. Relating to the commercial cannabis taxation program, County of San Diego (County) staff returned to the Board on May 10, 2022 (20), with a draft cannabis business tax ordinance and fiscal revenue analysis developed in conjunction with HdL Companies (HdL), the County's cannabis taxation program consultant.

Then, on June 14, 2022 (21), and June 28, 2022 (27), the Board took various actions necessary to place the cannabis business tax measure on the ballot for voter consideration during the consolidated general election on November 8, 2022. In addition to taking these actions, the Board directed the CAO to return to the Board to establish the actual tax rates should the measure be approved by the voters.

The Registrar of Voters certified the November 8, 2022, consolidated general election on December 8, 2022. The County's Cannabis Business Tax (Measure A) required a majority vote (50% plus one) to pass. Measure A passed with a final result of 57.45% of voters voting in favor of the measure.

Today's recommendation is for the Board to approve the introduction of an ordinance (first reading) setting the initial tax rates for the Cannabis Business Tax. If the Board takes action as recommended, then on February 28, 2023, staff recommends the Board adopt the Ordinance (second reading). If the proposed ordinance is altered on February 28, 2023, then on that date a subsequent meeting date will be selected for the ordinance's adoption.

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**RECOMMENDATION(S)  
CHIEF ADMINISTRATIVE OFFICER**

**On January 24, 2023:**

1. Consider and determine the methodology that should be used for taxation of cultivation businesses, as reflected in two alternative draft ordinances (Attachments A and B).
  - a. Percentage of Gross Receipts (Attachment A, on file with the Clerk of the Board)

OR

- b. Square Footage (Attachment B, on file with the Clerk of the Board)
2. Approve the introduction of the Ordinance (first reading), read title, and waive further reading of the Ordinance entitled:

AN ORDINANCE AMENDING THE SAN DIEGO COUNTY CODE OF REGULATORY ORDINANCES, TITLE 2, DIVISION 2, CHAPTER 4, RELATING TO SETTING INITIAL RATES FOR THE CANNABIS BUSINESS TAX

**If, on January 24, 2023, the Board takes the action recommended in Item 2 above, then, on February 28, 2023:**

Consider and adopt the Ordinance (second reading) entitled:

AN ORDINANCE AMENDING THE SAN DIEGO COUNTY CODE OF REGULATORY ORDINANCES, TITLE 2, DIVISION 2, CHAPTER 4, RELATING TO SETTING INITIAL RATES FOR THE CANNABIS BUSINESS TAX

**EQUITY IMPACT STATEMENT**

A disproportionate number of Black, Indigenous, and People of Color (BIPOC) individuals remain incarcerated for the past criminalization of cannabis. As cannabis is legalized and permitted in the unincorporated area of San Diego County, the Board saw the need to create a Socially Equitable Cannabis Program to help guide the County’s approach to this new potential revenue. On January 27, 2021 (4), the Board directed the CAO to develop a Socially Equitable Cannabis Program (Program) to include Zoning Ordinance and Regulatory Code amendments that allow for a variety of commercial cannabis uses, and a Social Equity Program to prioritize equity, access, and business opportunities to help rectify the injustices caused by the War on Drugs.

Specific to a cannabis taxation program, County staff and consultants engaged in three community outreach sessions where information was made available about cannabis history, market demand for cannabis, revenue generating strategies, future trends in cannabis, general tax ordinance structure and rates, and cannabis tax issues. Participants were given the opportunity to ask questions and provide comments about the topics discussed. Social equity considerations were a common theme in the feedback received, with comments including concerns that too high or too many taxes could be cost prohibitive for social equity businesses, suggestions to invest future tax

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revenues into social equity businesses or communities most impacted by the past criminalization of cannabis, and a sentiment that addressing historic and current inequities, not generating revenue, should guide the development of the tax ordinance.

The Office of Equity and Racial Justice (OERJ) will bring forward additional items to the Board relating to the Socially Equitable Cannabis Program at a later date.

### **SUSTAINABILITY IMPACT STATEMENT**

The Cannabis Business Tax was approved by the voters on November 8, 2022. Elections are the cornerstone of public participation in governmental decision making, which aligns with Goals #1 and #2 of the County of San Diego Sustainability Goals. Goal #1 is to engage the community in meaningful ways – today’s action is the culmination of many months of community engagement and public hearings related to the Cannabis Business Tax and is itself another opportunity for the community to participate in the decision-making process. Goal #2 is to provide just and equitable access to County services, policy decision-making, and resource allocation in support of sustainable communities. Sustainability includes four lenses (Social, Economic, Environmental, and Health & Wellbeing). The Cannabis Business Tax, being a general tax for the purpose of funding general governmental activities, can directly impact each of these areas of sustainability as funding is generated and allocated through the regular Operational Plan process.

### **FISCAL IMPACT**

Funds for this request are partially included in the Fiscal Year 2022-23 Operational Plan in the Treasurer – Tax Collector and Auditor & Controller departments. Additional costs will be incurred to administer the cannabis tax, including a net General Fund cost of \$323,311 and 2.50 additional staff years. In addition, the Chief Administrative Officer, Land Use and Environment Group and the Office of Equity and Racial Justice are working to identify staff resources needed for the establishment of an office that provides management and administration of activities leading towards the development and implementation of the County’s Socially Equitable Cannabis Program. It is anticipated that specific recommendations and fiscal impacts will be presented to the Board during the budget process.

If these actions are approved, according to HdL, the future annual estimate of the cannabis taxation program revenue at the rates that are proposed within this ordinance is \$2,930,000. This revenue projection depends on a variety of factors, including an increased concentration of retailers, market influences on the price of cannabis products as well as future policy and land use decisions by the Board, and it should not be assumed that these revenues will materialize within the first several years of the effective date of the tax rates. Using the current market as a basis, the initial revenue that may be generated through this action in Fiscal Year 2023-24 is approximately \$375,000. As the Cannabis Business Tax is a general tax, all tax proceeds will be placed into the General Fund for use at the discretion of the Board of Supervisors during the annual Operational Plan process.

### **BUSINESS IMPACT STATEMENT**

As of October 2021, the Board adopted ordinance amendments to allow the five existing cannabis dispensaries that were in operation in the unincorporated area prior to the County’s 2017

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prohibition on new medical facilities to continue operations and sell commercial medicinal and adult-use cannabis. Currently, no new dispensaries or other cannabis operations are permitted under the existing ordinances. The Land Use and Environment Group (LUEG) will bring forward additional items to the Board that would allow additional cannabis operations in the unincorporated area at a later date.

Cannabis businesses support a wide variety of other businesses that are not a part of the cannabis supply chain. Cultivators support garden supply stores, greenhouse manufacturers, irrigation suppliers, soil manufacturers, and a wide variety of contractors, including building and construction, lighting and electrical, HVAC, permitting, and engineering. Manufacturers support many of these same businesses, plus specialized tooling and equipment manufacturers, and product suppliers for hardware, packaging, and labeling. All these businesses support, and are supported by, a host of ancillary businesses, such as bookkeepers, accountants, tax preparers, parcel services, marketing and advertising agencies, personnel services, attorneys, mechanics, facilities maintenance, security services, and others. The cannabis business entrepreneur profits and the salaries paid to employees will move into the local economy, support stores, restaurants, car dealerships, contractors, home sales, and other businesses.

#### **ADVISORY BOARD STATEMENT**

N/A

#### **BACKGROUND**

On January 27, 2021 (4), the Board of Supervisors (Board) directed the Chief Administrative Officer (CAO) to explore the implementation of a commercial cannabis ordinance, regulations, and programs with a social equity component for the unincorporated area, including the development and implementation of a commercial cannabis taxation program. County staff in collaboration with HdL Companies (HdL), the County's cannabis taxation program consultant, completed three community engagement sessions in early February 2022 on cannabis tax policy to seek input that informed the ordinance development and overall fiscal analysis. The events were attended by both community members at large and those in the cannabis industry. Most of the feedback received at these events focused on the desired uses for taxation revenue in the future, such as support of social equity programs and preventative health and social programming. These sessions informed a draft cannabis business tax ordinance and fiscal revenue analysis (Report) developed in conjunction with HdL that was presented to the Board on May 10, 2022 (20). At this meeting, the Board directed the CAO to take various actions including returning to the Board on June 14, 2022, with all actions necessary to place the Ordinance on the ballot for the November 8, 2022, General Election.

Then, on June 14, 2022 (21), and June 28, 2022 (27), the Board took various actions necessary to place the cannabis business tax measure on the ballot for voter consideration during the consolidated general election on November 8, 2022. In addition to taking these actions, the Board directed the CAO to return to the Board to establish the actual tax rates should the measure be approved by the voters. The item before the Board today is to consider and adopt an ordinance setting the initial rates for the Cannabis Business Tax.

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Election Outcome and Maximum Rates

The Registrar of Voters certified the November 8, 2022, consolidated general election on December 8, 2022. The County’s Cannabis Business Tax (Measure A) required a majority vote (50% plus one) to pass. Measure A passed with a final result of 57.45% of voters voting in favor of the measure.

The passage of Measure A means Chapter 4 of Division 2 of Title 2 of the San Diego County Code of Regulatory Ordinances (County Code), entitled Cannabis Business Tax, was operative as of January 1, 2023. The tax applies only to the unincorporated area and provides that the Board may, by ordinance or resolution, increase or decrease the rate of the tax including setting the initial rate of the Cannabis Business Tax, without exceeding the maximum rates stated in the ordinance. Staff recommends setting and modifying any tax rates through ordinance for the purposes of transparency in current tax rates and providing for a single point of reference in the County Code for current rates. Staff further recommends an implementation date of April 1, 2023, with the first tax payments due in July 2023, in accordance with Section 22.406(C).

The County Code, as approved by the voters, sets the following as the maximum allowable tax rates for the Cannabis Business Tax:

Business Type	High Rate
Retail	6.0% of gross receipts
Manufacturer	4.0% of gross receipts
Distributor	3.0% of gross receipts
Cultivation	\$10/sf <i>or</i> 3.0% of gross receipts
Testing	2.0% of gross receipts

Considerations in Setting Tax Rates

The HdL Report presented to the Board on May 10, 2022 (20) and included in this Board Letter as Attachment D, included nine recommendations for the County to consider in developing the Cannabis Business Tax ordinance and ballot measure. These recommendations are included in an updated report from HdL entitled “Summary of Recommendations for Setting Cannabis Tax Rates” (Summary Memo, Attachment C). The Summary Memo also provides various considerations related to determining the methodology for taxation on cultivation businesses as well as revised recommendations on the initial tax rates for the Board’s consideration.

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The recommended initial rates for the Cannabis Business Tax are:

Business Type	Rate
Retail	4.00% of gross receipts
Manufacturing/Processing	2.50% of gross receipts
Distribution	2.00% of gross receipts
Cultivation	1.75% of gross receipts OR
Cultivation (Indoors)	\$7.00 per square foot
Cultivation (Mix-Light)	\$3.00 per square foot
Cultivation (Outdoors)	\$0.50 per square foot
Cultivation (Nurseries)	\$1.00 per square foot
Testing Laboratory	1.00% of gross receipts
Other	4.00% of gross receipts

Methodology for Taxation of Cultivation Businesses

The Cannabis Business Tax Ordinance allows the Board to set the tax rate for cannabis cultivation by either the gross receipts of the business or the square footage of the cultivation area, each of which has certain advantages and disadvantages. The recommendations before the Board on January 24, 2023, request the Board to consider and determine the methodology that should be used for taxation of cultivation businesses, as reflected in two alternative draft ordinances (Attachments A and B). The recommended rates for both methodologies take into consideration the potential tax burden and are designed to result in an equivalent tax on cultivation regardless of the methodology selected. Additional information about the methodology and assumptions in these calculations is available in the Summary Memo, Figure 6 (Attachment C).

Below is a summary of the considerations that are found in the Summary Memo.

- Gross Receipts of the Business (Attachment A)
  - Directly proportional to the business’s earnings, not through the net profits
  - Revenues generated for the County are less predictable as sales may rise and fall
  - Automatically adjusts for good sales years versus bad sales years
  - Automatically adjusts based on inflation
  - May require audit of businesses to ensure compliance with the Cannabis Business Tax
- Square Footage of the Cultivation Area (Attachment B)
  - Tax is tied directly to the square footage of cultivation area on the business’s permit
  - Amount of tax liability is known in advance to both the cultivator and the County
  - Occasional site inspections can confirm cultivation area
  - Rates vary between cultivation types to account for the different number of harvest cycles possible with each method and to reflect variation in market price
  - May require periodic reviews of the rates to ensure they are appropriately set based on the current market conditions

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Next Steps

Today's recommendation is for the Board to approve the introduction of an ordinance (first reading) setting the initial tax rates for the Cannabis Business Tax. If the Board takes action as recommended, then on February 28, 2023, staff recommends the Board approve the Ordinance (second reading). If the proposed ordinance is altered on February 28, 2023, then on that date a subsequent meeting date will be selected for the ordinance's adoption. The rates that are adopted by the Board will be in place until such time the Board takes an action to amend the rates.

**LINKAGE TO THE COUNTY OF SAN DIEGO STRATEGIC PLAN**

Today's proposed actions supports the Equity Strategic Initiative of the County of San Diego's 2023-2028 Strategic Plan by promoting economic sustainability for all and advancing opportunities for economic growth and development to all individuals and the community.

Respectfully submitted,



HELEN N. ROBBINS-MEYER  
Chief Administrative Officer

**ATTACHMENT(S)**

- Attachment A – Tax Rate Ordinance - Gross Receipts Method for Cultivation
- Attachment B – Tax Rate Ordinance - Square Footage Method for Cultivation
- Attachment C – HdL Companies Summary of Recommendations Memo
- Attachment D – HdL Companies Fiscal Revenue Analysis (April 2022)
- Attachment E – Summary of Proposed Ordinance