

Mendocino County Case Study

Thomson Reuters is helping Mendocino County make the most of new tax revenue from legal marijuana.



BY TAD SIMONS

Counting on Cannabis

In November 2016, when the state of California passed Proposition 64, legalizing recreational use of marijuana for adults, the tax implications were a bit murky. Seemingly everyone wants a piece of the billion-dollar-plus tax bonanza that legal cannabis is expected to provide, but the law—which went into effect on Jan. 1, 2018—only spells out what the state’s tax cut will be. Local cities and municipalities have the freedom to create and enforce their own cannabis tax ordinances, and governing bodies all over California have responded by doing just that, asking voters to approve a wide variety of cannabis-related tax proposals.

These new, voter-mandated cannabis taxes are presenting a variety of challenges for local governments, particularly in areas where cannabis has been a large part of the local economy for decades. In Mendocino County, officials are working hard to educate growers about the steps they need to take in order to comply with the state’s new regulations, a shift that involves changes in both policy and culture. One big change is a new tax on growers and cannabis-related businesses, the revenue from which will be used primarily for road repairs, youth drug-prevention efforts, and mental-health services.

New taxes require new systems. Soon after Mendocino County passed its own cannabis business-tax measure, the county asked Thomson Reuters for help developing a system to deal with the law’s new regulatory framework and tax structures. Mendocino County is among many counties in California that have contracted with Thomson Reuters for its Aumentum property tax and business-revenue modules. The challenge was to quickly configure the Aumentum system for a new tax type entering the formal economy in barely more than a year, as the people of California had only approved legalization in November of 2016.

Building Trust, Collecting Taxes

Software implementations for government entities are complex and typically take more time, but Thomson Reuters met the Mendocino challenge by thinking creatively and leveraging work it had already done elsewhere in California. Instead of starting from scratch, Thomson Reuters adapted a business-revenue module that had already been built for San Francisco, and was able to deliver a fully functional software package to Mendocino within the necessary time frame. The new module went live in September 2017, and the county’s tax collector is confident that the system will provide the crucial support needed to process the county’s new tax regulations.

Tax Canna-Bonanza

In its first year of legalization, the State of California is expected to generate more than \$1 Billion in tax revenue from sales of recreational marijuana—and that’s not including local city and county taxes. Colorado and Washington have the most mature legal-marijuana markets, and sales in both states continues to rise 20-30 percent per year.

Projected 2017 Sales Tax Revenue for Legal Cannabis

Alaska: \$9.6 million (projected 2017 sales tax revenue in first year of legalization)

Colorado: \$240 million (projected 2017 sales tax revenue)

Washington: \$280 million (for 2017 fiscal year ending June 30)

Nevada: \$190 million (projected 2017 fiscal-year tax revenue)

Sources: The Tax Foundation, Colorado Dept. of Revenue, Alaska Dept. of Revenue



The business-revenue module will help Mendocino County invoice and license cannabis-related businesses, track revenue, and make everything more efficient, which should help foster public trust in the overall process. That trust is essential, because California's regulatory efforts are complicated by the federal government's shifting policies on legalization.

As it is, the logistics of registering growers and enforcing new regulations are formidable. In Mendocino County, for instance, voters approved a 2.5 percent gross-receipts tax on cultivators, a five percent gross-receipts tax on dispensaries, and a \$2,500 annual flat tax on the cannabis supply chain—manufacturers, labs, and distributors. When the measure passed, Mendocino County tax collector Shari Schapmire's first thought was, "We've got to have some kind of software to accommodate this. What are we going to do?"

Complications with Compliance

Located three hours north of San Francisco, Mendocino County is part of the so-called "Emerald Triangle" (along with Humboldt and Trinity counties), the largest cannabis-producing region in the country. In Mendocino County alone, there are more than 5,000 independent growers, all of whom are now required by the state to register so that they can be properly regulated and duly taxed.

Collecting that local tax revenue is Schapmire's job—and it is a big one. Those who want to grow cannabis legally must obtain permits from both the state and local authorities, as well as comply with strict regulations regarding water sources, setbacks, drainage, pesticide use, and other restrictions. Getting growers to register is the first challenge.

"People want to be compliant. They want legitimacy. But there's a trust issue now, because there's still the issue that growing cannabis is federally illegal," Schapmire says.

By September, only 700 of the many thousands of growers in the county had voluntarily registered. "Our biggest goal now is to get any cannabis-related business registered and logged into the software. Cultivators, processors, manufacturers, labs, dispensaries, all of them," Schapmire says. Her hope is that registrations among cultivators will pick up once people see that their neighbors are cooperating.



Once growers are registered, the Aumentum business-revenue module will allow Schapmire to send timely invoices and issue licenses from within the software program. That may sound routine, except that one of the complicating factors with the new cannabis business tax is that it will be collected quarterly. Also, because cultivators do not generate revenue every quarter due to their crop's growing cycle, the county has imposed a minimum fee of \$1,250 to \$5,000 per growing cycle, depending on the size of the plot.

"The biggest issue we have right now is this is a gross receipts tax, first and foremost, but due to the minimum requirements there will be true-up issues at the end of each fiscal year," Schapmire explains. "This is very challenging, but we are moving forward."

Then there are the taxes and assessments coming in from other sources that have nothing to do with cannabis. "In addition to collecting property tax, we also collect a transient occupancy tax, a tourism assessment, and issue general business licenses," Schapmire says. "I wanted a software product that could accommodate all of our taxing and licensing needs, which is why we chose Aumentum."

Another challenge Schapmire faces is that cannabis is largely a cash business. Banks are still reluctant to participate in the cannabis economy, so, for instance, many of Mendocino County's residents pay their property taxes by showing up at Schapmire's office with large bundles of cash. Her office has cash-counting machines and an armored truck shows up every day to take the cash away. Schapmire estimates that at least 60 percent of the cannabis economy is cash, and until some sort of banking system for the cannabis industry is created, it is expected to stay that way.

Managing all of these regulatory changes would be even more difficult if Mendocino County didn't already have a head start on the rest of the state. Before Prop. 64 passed, the county's board of supervisors had already spent years crafting local cannabis regulations to address issues related to the medical market. The cannabis business tax went into effect on Jan. 1, 2017, but the only taxable businesses at that time were medical dispensaries because they were already regulated by business licenses. The cultivation business tax did not go into effect until May 4, 2017, after the adoption of the Cultivation Ordinance—and even that was complicated by wildfire damage in October.

"Some of the cannabis was affected by the fires because it was still in the ground," Schapmire says. "We heard reports about fire damage, smoke damage, and theft because of mandatory evacuations." First-quarter returns were due Oct. 31, but the county gave affected residents an extension to Nov. 30 to remit their taxes.

All Systems Go

In order to handle all of these moving parts, the system Thomson Reuters developed for Mendocino County was configured to include all the specifications for the county's ordinances. To do that, the Thomson Reuters team stripped the data out of San Francisco's business module, then re-configured it to fit the requirements for Mendocino County.

As a result, everything was ready on Jan. 1, 2018, when the state regulation went into effect. "The tax is already in place, and our systems are in full swing," Schapmire says. Revenue from the tax will go into the county's general fund, and voters have already indicated that they want the money spent on cannabis enforcement, road improvement, and mental health services.



Photo courtesy Swami Select

"Thomson Reuters was extraordinarily responsive in allowing us to have the business-revenue module first, and in helping us figure out how to make it happen," Schapmire says.

While the rest of California grapples with the logistics of legalization in the coming year, Schapmire and her team are confident that the transition in Mendocino will be smooth, and that collection and distribution of the county's new taxes will be relatively routine.

For them, the hardest part is already over.

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