STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date:	**02/22/13**	Bill No:	**Senate Bill 782**
Tax Program:	**Sexually Oriented Business**	Author:	**DeSaulnier**
Sponsor:	**CALCASA**	Code Sections:	**RTC Part 14.7 (commencing with Section 34001)**
Related Bills:		Effective Date:	**01/01/14**

This analysis only addresses the provisions that impact the BOE.

BILL SUMMARY

This bill imposes a $10 per customer visit tax on sexually oriented business operators, inclusive of admission and reentry.

ANALYSIS

CURRENT LAW

Under existing law, California does not impose a tax or surcharge on general admissions. However, various local communities impose an admissions tax. For example, the City of Santa Cruz imposes a 5 percent admissions tax; the City of San Mateo levies a 50-cent tax on admissions to horse or harness racing events; and the City of Fairfield levies a $5 admission tax for the privilege of playing golf.

At the state level, the State Athletic Commission levies a 5 percent admission fee related to boxing, kickboxing, and martial arts exhibitions (contests) and wrestling exhibitions. The admissions fee is imposed on a promoter or other organization that conducts contests or wrestling exhibitions.

PROPOSED LAW

This bill enacts the Sexual Assault Victims Equity Act (Act) in Part 14.7 (commencing with Section 34001) of Division 2 of the Revenue and Taxation Code. The Act imposes a tax upon persons operating (operators) a sexually oriented business (business) for the privilege of operating the business. The bill specifies a tax rate of $10 per customer visit, inclusive of admission and reentry.

The bill requires an operator to record daily the number of customers admitted to the business.

Administration. This bill requires the Board of Equalization (BOE) to administer and collect the tax pursuant to the Fee Collection Procedures Law (FCPL)[1]. For purposes of the tax, the bill clarifies the terms “fee” and “feepayer” as follows:

- “Fee” includes the sexually oriented business tax; and
- “Feepayer" includes the person that is required to pay the tax.

The FCPL generally provides for the BOE’s administration of fee programs. Among other things, the FCPL provides for collection, reporting, return, refund, and appeals procedures, as well as the BOE’s authority to adopt regulations related to the FCPL’s

[1] Part 30 (commencing with Section 55001)) of Division 2 of the Revenue and Taxation Code.

administration and enforcement. The bill also specifically authorizes the BOE to prescribe, adopt, and enforce tax administration and enforcement regulations.

Definitions. The bill defines the terms "nude" and "sexually oriented business":

- "Nude" means clothed in a manner that leaves uncovered or visible through less than fully opaque clothing, any portion of the genitals or, in the case of a female, any portion of the breasts below the top of the areola of the breasts.
- "Sexually oriented business" means a nightclub, bar, restaurant, or similar commercial enterprise that does both of the following.
    - Provides for an audience of two or more individuals live nude entertainment or live nude performances where the nudity is a function of everyday business operations and where nudity is a planned and intentional part of the entertainment or performance.
    - Authorizes on-premises alcoholic beverage consumption regardless of whether the consumption is under an Alcoholic Beverage Control Act license or permit.

Registration, Reporting, and Payment. The bill requires persons operating a sexually oriented business to register with the BOE, through a BOE prescribed application, as described.

The tax and electronically-filed returns would be due "on or before the last day of the month following each calendar quarter."

Both the application and tax return would be authenticated in a form or pursuant to a method as may be prescribed by the BOE.

The bill requires the BOE to transmit all payments, less refunds and BOE administrative costs, to the Treasurer. The Treasure will deposit those funds into the Sexual Assault Treatment and Prevention Fund (Fund), which the bill creates in the State Treasury. Upon appropriation by the Legislature, the Office of Emergency Services (OES) will use the funds in accordance with Health and Safety Code Section 26300, also added by the Act. That section requires allocation of the funds as follows:

- Grant awards for:
    - intervention services related to sexual assault survivors and rape prevention programs provided by rape crisis centers; programs for the intervention and prevention of sexual violence;
    - outreach programs, training, and technical assistance to and support of California rape crisis centers; civil legal services to sexual assault survivors, coordination of sexual assault teams;
    - culturally and linguistically appropriate intervention services to sexual assault survivors; and
    - support of intervention and treatment services for victims of sexual exploitation of human trafficking and sexual assault as part of dating or domestic violence.
- OES grant program administration.
- A specified OES-created report to the Governor and the Legislature.

Miscellaneous. An operator would not be permitted to require that the tax be reimbursed by an employee or independent contractor of the sexually oriented business. However, the operator may seek reimbursement from the customer, as the BOE prescribes.

The bill becomes operative on the first day of the first calendar quarter commencing more than 90 days after the effective date of the Act.

BACKGROUND

Recent measures have proposed similar taxes.

AB 2441 (Williams, et al, 2012) would have imposed a $10 per customer visit tax upon an operator. That bill was held under submission in the Assembly Revenue and Taxation Committee.

AB 847 (Salas, 2009) would have imposed a 20 percent adult entertainment venue gross receipts tax. This bill failed passage in the Assembly Revenue and Taxation Committee.

AB 2914 (Calderon, 2008) would have imposed (1) a 25 percent adult entertainment venue tax, and (2) an 8 percent adult material tax. This bill was held on the suspense file in the Assembly Appropriations Committee.

AB 1551 (Calderon, 2007) would have imposed an 8 percent adult entertainment venue gross receipts tax, and a pay-per-view adult entertainment movie total gross charge. This bill was never heard in committee.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the California Coalition Against Sexual Assault (CALCASA). The sponsors wish to establish a revenue stream to help fund various intervention services and rape prevention programs. These services would include outreach, training, civil legal services to sexual assault survivors, response teams, and forensic exams.

2. **What is a sexually oriented business?** This bill defines the person subject to the proposed tax to be an operator of a nightclub, bar, restaurant, or similar commercial enterprise that:

   - Provides for an audience of two or more individuals live nude entertainment or live nude performances, **and**
   - Authorizes on-premises alcoholic beverage **consumption**, regardless of whether the consumption of such beverages is under an Alcoholic Beverage Control Act (ABC Act) license.

   Accordingly, operators that provide nude entertainment and authorize on-premise alcohol consumption, whether or not licensed, are subject to the tax. However, the ABC Act prohibits alcoholic beverage consumption at an unlicensed business premises pursuant to Business and Professions Code (BPC) Section 25604. Such an unlicensed business would be difficult, if not impossible, for the BOE to identify and register for tax collection. To address this concern, BOE staff suggests an amendment to require the Department of Alcoholic Beverage Control to notify and provide information to the BOE regarding any operator found in violation of BPC Section 25604.

The bill specifically excludes unexpected nudity or an occasional wet t-shirt contest from the "sexually oriented business" definition. The bill also excludes a business that provides full nude entertainment[2] unless the business permits (unlawful) on-premises alcohol consumption.

3. **Operator versus owner.** The tax is imposed on "all persons who operate" a sexually oriented business. An operator could include a manager, employee, or other person who does not exercise control over the business. BOE staff recommends clarifying the "person" subject to the sexually oriented business tax.

4. **Longer delayed operative date is necessary.** To effectively implement this bill, the BOE must: notify and register taxpayers; develop computer programs; hire and train key staff; create necessary forms and schedules; and answer taxpayer inquiries. These functions must take place before the tax becomes operative.

   The current delayed operative date of "the first day of the first calendar quarter commencing more than 90 days after the effective date of this Act" is insufficient. BOE staff estimates the new tax program implementation to take a minimum of six months. Accordingly, BOE staff recommends an amendment to delay the tax operative date to the first day of the first calendar quarter commencing more than *180* days after bill enactment.

5. **Administrative start-up cost funding is essential.** This bill delays the operative date to the first day of the first calendar quarter commencing more than 90 days after bill enactment. As a result, the BOE must begin to implement the bill in fiscal year 2013-14. However, the BOE's 2013-14 budget does not include funding to implement the bill. Consequently, the BOE requires an adequate appropriation to cover administrative implementation costs.

   Typically, the BOE seeks administrative cost reimbursement from the account or fund into which tax proceeds are deposited. However, this bill creates the Fund, which lacks funding to reimburse the BOE prior to collection of the tax. Upfront BOE implementation cost reimbursement is essential. As such, BOE staff suggests the bill authorize a loan from the General Fund, or other eligible fund, to the Fund. The loan would be repaid from taxes collected.

   Constitutional and statutory provisions prohibit the BOE from using special fund appropriations to support the administration of the proposed tax program. Without an appropriation, it may be necessary for the BOE to divert General Fund (GF) dollars to implement the proposed tax program. A GF diversion typically results in a negative impact on GF-supported programs and related State and local government revenues.

[2] Clubs providing full nude entertainment are prohibited from licensing under the ABC Act pursuant to Rule 143.2, which provides, in part, that "live entertainment is permitted on any licensed premises, except that no license shall permit any person to perform acts of…displaying the pubic hair, anus, vulva or genitals."

6. **Suggested amendments.** The bill specifically prohibits an operator from requiring tax reimbursement from an employee or independent contractor. As the tax administrator, the bill therefore requires the BOE to investigate such employee tax reimbursement violations. Perhaps the Employment Development Department is the agency best charged to determine violations under this provision. BOE staff also suggests a penalty be imposed upon a business operator that violates this provision.

   Furthermore, the bill authorizes an operator to pursue tax reimbursement from the customer. However, an operator may simply pursue that reimbursement in the form of an increased admission or cover charge. BOE staff suggests an amendment to remove authorized reimbursement language. This amendment would also reduce BOE audit-related workload and costs to verify proper reimbursement.

7. **First amendment issues.** In 2007, the Texas Legislature enacted a statute that imposed a $5 per customer tax on sexually oriented businesses. A sexually oriented business was defined as a nightclub, bar, or similar enterprise that provided live nude entertainment and authorized consumption of alcoholic beverages. Karpod, Inc., a sexually oriented business located in Texas, and Texas Entertainment Association, Inc., which represented sexually oriented business interests, sued the Texas Comptroller of Public Accounts for declaratory and injunctive relief. The trial court concluded the statute violated the First Amendment to the U.S. Constitution. The Texas Court of Appeals, Third District, affirmed the trial court's decision. (*Combs v. Texas Entertainment Assn., Inc.* (2009) 287 S.W.3d 852.)

   The Comptroller again appealed, and, on August 26, 2011, the Texas Supreme Court, in *Combs v. Texas Entertainment Assn., Inc.* (347 S.W.3d 277), reversed the appeals court decision. They concluded that the tax (a tax very similar to that imposed by this bill) was constitutional and did not violate the First Amendment. Relying on several recent United States Supreme Court opinions (including one out of California – *City of Los Angeles v. Alameda Books, Inc.* (2002) 535 U.S. 425), the Texas Supreme Court concluded that the tax was clearly directed at the secondary effects of nude dancing when alcohol is being consumed and not at expression in nude dancing. Further, a business could avoid the tax altogether by not allowing alcohol to be consumed. Finding that the tax met all four factors of what is known as the *O'Brien* test (*United States v. O'Brien* (1968) 391 U.S. 367, 377), including that the tax was no greater a restriction than was essential to the furtherance of the state's interest, the Texas Supreme Court upheld the tax and found that it did not violate the right to freedom of speech (i.e., expression in nude dancing).

   On January 23, 2012, the United States Supreme Court rejected the sexually oriented business's petition seeking review of the case. (*Texas Entertainment Assn. v. Combs* (2012) 132 S.Ct. 1145.)

COST ESTIMATE

BOE administrative costs related to this bill are substantial. These costs include: taxpayer identification, notification, and registration; regulation development; manual and publication revisions; tax return design; computer programming; audit and collection tasks; staff training; and public inquiry responses.

A detailed cost estimate is pending.

REVENUE ESTIMATE

The revenue estimate for this bill is subject to considerable uncertainty. Due to the lack of published information on California's sexually oriented industry, we are not aware of any attendance figures that could be used to develop a reliable revenue estimate.

Approximately 180 sexually oriented businesses currently operate in California, roughly 80 of which serve alcohol and thus are subject to the proposed tax. To establish an order of magnitude, if we conservatively assume that the average daily attendance statewide is 120 persons, this bill would generate $35 million (365 days multiplied by 80 businesses multiplied by 120 persons per day multiplied by the $10 tax rate). However, actual revenues could be higher or lower to the extent that actual attendance differs from the assumed daily average.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

Analysis prepared by:	Cindy Wilson	916-445-6036	04/16/13
Revenue estimate by:	Ronil Dwarka	916-445-0840	
Contact:	Michele Pielsticker	916-322-2376	

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This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.