STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date:	**02/24/12**	Bill No:	**Assembly Bill 2441**
Tax Program:	**Sexually Oriented Business**	Author:	**Williams, et al**
Sponsor:	**CALCASA**	Code Sections:	**RTC Part 14.7 (commencing with Section 34001)**
Related Bills:		Effective Date:	**Upon enactment, but operative 01/01/13**

BILL SUMMARY

This bill imposes upon the privilege of operating a sexually oriented business (SOB), as defined, a tax at the rate of ten dollars ($10) per entry to the business by a customer per visit to be administered by the Board of Equalization (BOE).

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 an admission tax of five dollars ($5) for the privilege of playing golf.

At the state level, the State Athletic Commission levies a fee on admissions to boxing contests or wrestling exhibitions. The law requires the promoter or other organization conducting the boxing, kickboxing, martial arts, or wrestling contest to pay the commission a fee of 5% of the amount actually paid for admission to a contest, except that the fee may never be less than $1,000 for a professional contest and $500 for an amateur contest.

PROPOSED LAW

This bill would add Part 14.7 (commencing with Section 34001) to Division 2 of the Revenue and Taxation Code to impose a tax upon the privilege of operating a SOB at the rate of ten dollars ($10) per entry to the business by a customer per visit.

The SOB would be required to record daily the number of customers admitted to the business, maintain those records for the period required by the BOE, and make the records available for inspection and audit.

Administration. The BOE would administer and collect the tax pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001). For purposes of the SOB Tax, the references in the Fee Collection Procedures Law to “fee” would include the tax imposed by this bill and references to “feepayer” would include a person required to pay that tax.

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.

The Fee Collection Procedures Law contains "generic" administrative provisions for the administration and collection of fee programs to be administered by the BOE. It was added to the Revenue and Taxation Code to allow bills establishing a new fee to reference this law, thereby only requiring a minimal number of sections within the bill to provide the necessary administrative provisions. Among other things, the Fee Collection Procedures Law includes collection, reporting, refund, and appeals provisions, and it provides the BOE the authority to adopt regulations relating to the administration and enforcement of the Fee Collection Procedures Law.

The BOE would be authorized to prescribe, adopt, and enforce regulations relating to the administration and enforcement of the SOB Tax.

Registration, Reporting, and Payment. Each quarter, a SOB would be required to remit the tax to the BOE in the manner prescribed by the BOE, and to file a report with the BOE in the manner and containing the information required by the BOE. The BOE would transmit all payments, less refunds and the BOE's costs of administration, to the Treasurer to be deposited in the State Treasury to the credit of the Sexual Assault Treatment and Prevention Fund (Fund), which this bill creates. Moneys in that fund would, upon appropriation by the Legislature, be used as specified in Health and Safety Code Section 26300, which this bill would add as Chapter 20 (commencing with Section 26300) of Division 20. Specifically, Section 26300 provides that the funds be used by the following:

- The State Department of Public Health to measure the prevalence of sexual assault in California and for grants to support programs assisting victims of sexual exploitation and of human trafficking.
- The California Emergency Management Agency to, in part, award grants for: programs providing certain services related to sexual assaults; nonprofit, community-based organizations providing sexual violence awareness, intervention, and prevention programs; forensic examination rape kits; technology support in rape crisis centers; and civil legal services to provide legal assistance for sexual assault victims.

Definitions. The bill defines the following terms:

- "Nude" to mean either entirely unclothed, or clothed in a manner that leaves uncovered or visible through less than fully opaque clothing, any portion of the genitals or buttocks or, in the case of a female, any portion of the breasts below the top of the areola of the breasts.
- "Sexually oriented business" to mean 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.
    - Authorizes on-premises consumption of alcoholic beverages, regardless of whether the consumption of alcoholic beverages is under a license or permit issued under the Alcoholic beverage Control Act.

Miscellaneous. The bill provides that a business may not require the tax to be reimbursed by an employee of the SOB, but may require the tax to be reimbursed by the customer whose entry the tax is imposed upon, in a manner prescribed by the BOE.

The bill would become effective on January 1, 2013.

BACKGROUND

Recent measures have proposed similar taxes.

AB 847 (Salas, 2009) would have imposed a 20-percent tax on the gross receipts, as specified, of an adult entertainment venue, as defined, in this state. The revenues derived from the tax would be transferred to a newly created Adult Entertainment Impact Fund. This bill failed passage in the Assembly Revenue and Taxation Committee.

AB 2914 (Calderon, 2008) would have imposed 1) a 25-percent tax on the gross receipts of an adult entertainment venue, as defined, and 2) an 8-percent tax on the sale or purchase of tangible personal property that is adult material, as defined, including digitally transmitted adult material, and the qualified gross receipts of a qualified business, as defined, where the business has more than 50 percent of its gross receipts derived from the production, distribution, or sales of adult entertainment movies. This bill was held on the suspense file in the Assembly Appropriations Committee.

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

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the California Coalition Against Sexually Assault (CALCASA) and is intended to establish a revenue stream to help fund sexual assault awareness, outreach, training and technical assistance, intervention and prevention, programs that support victim advocacy, and forensic exam rape kit processing.

2. **What is a sexually oriented business?** This bill defines the category of business which would be subject to the tax to be 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 **<u>and</u>** authorizes on-premises **consumption** of alcoholic beverages, regardless of whether the consumption of such beverages is under a license issued under the Alcoholic Beverage Control Act.

   It is not entirely clear which businesses would be subject to the tax. Specifically, what does "authorizes on-premises consumption of alcoholic beverages" mean? Would businesses commonly known as "juice bars" be subject to the tax? For example, clubs providing full nude entertainment are prohibited from licensing under the Alcoholic Beverage Control 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." Does the second criterion address "juice bars" (clubs that provide nude entertainment and sell juices and non-alcoholic sodas instead of alcoholic beverages), which may not hold Alcoholic Beverage Control licenses or **sell** alcoholic beverages, if they permit customers to **consume** alcoholic beverages on their premises?

   It is also not clear if a business occasionally hosting an event that meets the definition of a SOB would be subject to the proposed tax, such as a club hosting a wet t-shirt contest.

3. **Who is the taxpayer?** The bill imposes the proposed tax upon "the privilege of operating a sexually oriented business" rather than a person. Although the bill makes reference that the tax is intended to be imposed upon the SOB, the bill

should be amended to clarify that intent. The following language is suggested:

> **34003.** On or after January 1, 2013, a tax is hereby imposed upon ~~the privilege of operating~~ a sexually oriented business at the rate of ten dollars ($10) per entry to the business by a customer per visit.

4. **Delayed operative date necessary.** To effectively implement this bill, it would be necessary for the BOE to notify and register SOBs, develop computer programs, hire and train key staff, create necessary forms and schedules, and answer taxpayer inquiries. These functions should take place before the tax becomes operative.

   BOE staff estimates that it would take a minimum of six months to implement the new program proposed by this bill. In order to provide the BOE with the necessary 6-month lead time, it is suggested that the bill be amended to provide for a delayed operative date to the first day of the first calendar quarter commencing more than six months after the bill is enacted. This would provide the BOE with sufficient lead time to successfully implement the bill and would be consistent with the quarterly reporting basis proposed by this measure.

5. **How would the BOE be funded for administrative start-up costs?** This bill proposes a tax to be imposed beginning January 1, 2013. In order to notify and register taxpayers, develop computer programs and reporting forms, and hire appropriate staff, an adequate appropriation would be required to cover the BOE's administrative costs that would not already be identified in the BOE's 2012-13 budget.

   Typically, the BOE would seek payment from the Fund for administrative start-up costs through the budget change proposal (BCP) process. However, the Fund would not have a balance to reimburse the BOE's administrative start-up costs prior to the collection of the tax. To address this funding issue, this bill should be amended to add language authorizing a loan from the General Fund, or other eligible fund, to the Fund, to be repaid from taxes collected.

   Constitutional and statutory provisions prohibit the BOE from using special fund appropriations to support the administration of the SOB tax program. Without an appropriation for administrative start-up costs, the BOE would have to divert General Fund dollars to the proposed tax program, which would have a negative impact on the revenues of State and local government.

6. **Suggested amendments.** The following amendments are suggested to allow for the effective and efficient administration of the proposed tax program.

   - **Redundant language.** The BOE would administer the proposed tax pursuant to the Fee Collection Procedures Law, which, among other things, contains provisions relating to the BOE's authority to examine books and records of any taxpayer and record retention. Accordingly, the duplicative language contained in Section 34004 that provides, "*The business shall maintain the records for the period required by the board and shall make the records available for inspection and audit upon the request of the board*" may be deleted.

   - **Electronic registration and filing; specified due date for the return.** All new programs administered by the BOE should comport with the BOE's electronic services projects and activities, which include, in part, internet registration and the transition to e-filing. The language below is suggested, which also includes a specified date by which the return is due to the BOE:

34006. ~~Each quarter a sexually oriented business shall do both of the following:~~

~~(a) Remit the tax imposed under Section 34003 to the board in the manner prescribed by the board.~~

~~(b) File a report with the board in the manner and containing the information required by the board.~~ (a) On or before the last day of the month following each calendar quarter, a return for the preceding quarterly period shall be filed using electronic media with the board.

(b) The board may prescribe those forms and reporting requirements as are necessary to implement the tax, including, but not limited to, information regarding the number of entries to the business and the amount of tax due.

34006.5. Every sexually oriented business required to pay the tax imposed under this part shall register with the board. Every application for registration shall be made upon a form prescribed by the board and shall set forth the name under which the applicant transacts or intends to transact business, the location of his or her place or places of business, and such other information as the board may require. An application for an account shall be authenticated in a form or pursuant to methods as may be prescribed by the board.

- **What is considered an "entry" and a "visit"?** This bill imposes a tax on each entry to the business by a customer per visit. Does "entry" and "visit" include each time the customer enters the business? Or does it include unlimited entries for each visit, meaning the customer can leave the premises of the business? Or does it include more than one entry by the same customer on the same business day at the same location? The incidence of tax should be clarified, including definitions for pertinent terms such as "customer."

- **Tax reimbursement by employee.** The bill prohibits reimbursement of the proposed tax by an employee of the SOB. It appears the BOE, a tax administration agency, would be required to investigate and determine whether or not a SOB requires reimbursement from an employee. Perhaps the EDD is the agency best charged with making a determination under this provision.

  Furthermore, the bill authorizes the SOB to be reimbursed for the tax by the customer whose entry the tax is imposed upon, in a manner prescribed by the BOE. This provision is unnecessary since the SOB can simply pass on the tax to the customer in the form of an increased admission or cover charge. The language should be removed.

7. **First amendment issues.** In 2007, the Texas Legislature enacted a statute that imposed a tax on sexually oriented businesses in the amount of $5 for each customer entry. A sexually oriented business was defined by the statute 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, and 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 Controller 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 and determined that this tax, a tax very similar to the tax 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, not at expression in nude dancing, but at the secondary effects of nude dancing when alcohol is being consumed and, further, that 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 statute and the tax and held 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 SOB's petition seeking review of the case. (*Texas Entertainment Assn. v. Combs* (2012) 132 S.Ct. 1145.)

COST ESTIMATE

The BOE would incur substantial costs to administer this bill. These costs would be attributable to, among other things, identifying and notifying taxpayers, developing regulations, revising manuals and publications, creating a new tax return, computer programming, training staff, and answering numerous inquiries from the public.

This bill provides that a portion of the revenues generated from the new tax would pay for the BOE's costs of administration. A detailed cost estimate is pending.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

This bill would impose a tax upon the privilege of operating a SOB at the rate of ten dollars ($10) per entry to the business by a customer per visit.

The bill defines the following terms:

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REVENUE SUMMARY

The revenue estimate for this bill is subject to considerable uncertainty. Our research indicates that there is a paucity of published information that would describe and provide a background about the SOB industry in California. Simply stated, this bill would impose a per-person admissions tax on specified SOBs, and 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 would be required to collect the tax under the bill's provisions. To establish an order of magnitude, if we conservatively assume that the average daily attendance statewide is 120 persons, this measure would generate $35 million in revenue (365 days multiplied by 80 businesses multiplied by 120 persons per day multiplied by the $10 tax rate). However, actual revenues could be significantly different (higher or lower), to the extent that actual attendance differs from the daily average we have assumed. Additionally, standard microeconomic theory suggests that attendance would decline somewhat in response to the imposition of the tax; however, the extent of the decline is unknown.

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