



# MEMORANDUM

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**TO:** Mike Rankin  
City Attorney

**DATE:** May 18, 2009

**FROM:** Dave Deibel  
Princ. Asst. City Atty.

**SUBJECT:** IMPOSITION OF OCCUPATIONAL LICENSE TAX ON ENTERTAINMENT FACILITIES AND ADULT ORIENTED BUSINESSES

You inquired as to whether the City could 1) impose an occupational license tax on each patron who entered an adult oriented businesses and 2) impose the same tax on all entertainment venues. The short answers are: 1) a separate tax on adult oriented businesses would be unconstitutional<sup>1</sup>; and 2) it would be possible to impose such a tax on the entire entertainment industry but it would require a complete change to the way such businesses are taxed now.

The entertainment offered at adult oriented businesses and the products sold at such businesses have been held to have protections under both the United States' and Arizona's constitutions. *City of Renton v. Playtime Theatres, Inc.* 475 U.S. 41, 106 S.Ct. 925 (1986); *State v. Stummer*, 194 P.3d 1043, 1050 219 Ariz. 137 (2008). Any regulation, tax, or fee imposed only on such businesses must survive a strict scrutiny test in order to be found constitutional unless the regulation, tax, or fee is addressing a negative secondary effect caused by the businesses. In such a case an intermediate scrutiny test is applied by the courts.

A Texas Superior Court recently struck down a Texas law imposing an excise tax solely on adult oriented businesses finding that it failed the federal intermediate scrutiny test. In Texas, the law only applied to adult oriented businesses that sold alcohol and the state argued that there were more negative secondary effects at those establishments than at similar businesses that did not serve alcohol. *Texas Entertainment Association v. Combs*, No. D-1-GN-07-004179 (Tx.Dist.Court. 345 2008). The case is now on appeal but the Texas legislature is set to repeal the law to settle the case.

Recently, the Arizona Supreme Court refused to follow the federal test on intermediate scrutiny and used an even stricter application. *Stummer, Id.* Under the stricter Arizona test it is doubtful that this proposed tax would survive intermediate scrutiny by the courts given the fact that City licensed establishments are prohibited from serving

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<sup>1</sup> Adult entertainment establishments that serve alcohol are licensed by the State and would not be subject to the proposed tax in any event.

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alcohol. Additionally, the tax proposed in the instant case is not designed to address any negative secondary effects but is simply a revenue raising measure. In that case strict scrutiny is applied and the tax would certainly not withstand constitutional muster under that test.

The City could impose an occupational license tax on all entertainment establishments to avoid singling out adult oriented businesses. However, the City, as well as the state, already imposes a 2% transaction privilege tax on this activity, which includes movie theaters, concert halls, carnivals, races, and fairs among the many listed in the Code. Tucson Code § 19-410(a). Since the Charter prohibits imposing a transaction privilege tax on any business that pays an occupational license tax (Tucson Charter Chap IV, § 2) the City would have to zero out the transaction privilege tax on that activity and impose an occupational license tax on the industry. Since many of these venues also sell items at retail and collect a transaction privilege tax on those items, the businesses would have to separately account for entrance fees and other consumer transactions. This would impose a significant burden on industry that currently pays only a transaction privilege tax on almost all of its activity.

It should be pointed out that the Mayor and Council zeroed out the City's employee based occupational license tax on September 5, 2007. In order to simplify how businesses acquire business licenses and pay taxes, the City went to one business license for all businesses, both retail and service, that had to be renewed annually for a fee.<sup>2</sup> In order to keep the change revenue neutral for the service based businesses, the employee based occupational license tax was set to zero.

c: Sylvia Amparano, Richard Putz

DD/kr

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<sup>2</sup> Previously, businesses received a license when opening but it had no expiration date. Now the licenses are good for one year and there is a \$45.00 renewal fee.