MEMORANDUM OF LAW

DATE: September 21, 1992

TO: Patricia T. Frazier, Financial Management Director

FROM: City Attorney

SUBJECT: Legality of Imposing an Admissions Tax

You asked this office to evaluate the viability of structuring an admissions tax, levied for general government purposes, that would avoid legal challenges.

An admissions tax raises concerns in two areas discussed below: 1) voter ratification under Article XIIIA of the California Constitution; and 2) freedom of speech under the First Amendment of the United States Constitution.

Although an admissions tax levied for general governmental purposes, with monies deposited into a general fund, would not require voter ratification, it could violate the First Amendment. More information is needed to ascertain whether the tax would unfairly burden businesses engaged in protected speech, such as motion picture theaters, to determine the risk of challenges on First Amendment grounds.

DISCUSSION

1. Article XIIIA

LEVYING AN ADMISSIONS TAX TO FUND GOVERNMENT SERVICES, WITH MONIES GOING INTO THE GENERAL FUND, WOULD NOT REQUIRE VOTER RATIFICATION UNDER ARTICLE XIIIA OF THE CALIFORNIA CONSTITUTION.

Evaluating the legality of an admissions tax requires analysis under Article XIIIA of the California Constitution. Voters approved Article XIIIA (Proposition 13) in 1978. In addition to stemming rapidly rising property taxes, it restricted the ability of cities, counties and districts to raise revenue. Section 4 of the amendment, relevant to this discussion, provides that cities, counties and special districts may not impose special taxes without voter approval by a two-thirds majority of the electorate.

The California Supreme Court has construed the term "special taxes" in Section 4 to mean "taxes which are levied for a specific purpose rather than . . . a levy placed in the general

fund to be utilized for general governmental purposes." City and County of San Francisco v. Farrell, 32 Cal.3d 47, 57 (1982). Because the levy in Farrell was placed in the city's general fund, it was deemed a general tax beyond the reach of Section 4.

In contrast, a special tax is one collected and earmarked for a special purpose, not deposited in a general fund. Farrell, 32 Cal.3d at 53, quoting County of Fresno v. Malmstrom, 94 Cal.App.3d 974, 983 (1979). Even though a tax is levied to fund specified city services, it is considered a general tax if monies go into a general fund. City of Oakland v. Digre, 205 Cal.App.3d 99 (1988). More recently, the Supreme Court affirmed the Farrell definition and held that a special tax is one levied to fund a specific governmental project or program. The court acknowledged that under this principle, every tax levied by a "special purpose" district would be deemed a special tax. Rider v. County of San Diego, 1 Cal. 4th 1, 15 (1991.)

Thus, if an admissions tax were collected and earmarked for a special purpose, Section 4 would require voter ratification by a supermajority. However, if an admission tax were levied to fund general governmental services and deposited in the general fund, Section 4 would not require voter ratification.

2. The First Amendment

AN ADMISSIONS TAX COULD VIOLATE THE FIRST AMENDMENT IF IT FALLS DISPROPORTIONATELY ON BUSINESSES ENGAGED IN FREE SPEECH.

Governments have broad powers to classify people or property for taxation purposes, subject only to the limitations of the state and federal Constitutions. Fox Bakersfield Theatre Corporation v. City of Bakersfield, 36 Cal.2d 136, 141 (1950). One such limitation is the First Amendment to the United States Constitution, which prohibits enactment of any law that abridges freedom of speech. The First Amendment applies to state and municipal action pursuant to the Fourteenth Amendment. City of Alameda v. Premier Communications Network Inc., 156 Cal.App.3d 148, 152 (1984), cert. denied, 469 U.S. 1073 (1984). First Amendment rights may be violated by direct regulation of speech based on content, or by an indirect or incidental regulation of speech resulting from the pursuit of governmental goals unrelated to freedom of expression. Times Mirror Co. v. Los Angeles, 192 Cal.App.3d 170, 179 (1987). An admissions tax falls into the latter category.

Accordingly, businesses engaged in protected speech, such as motion picture theaters, must receive special deference. Such businesses may not be singled out for discriminatory tax treatment, unless the state shows a counterbalancing interest of

compelling importance that it cannot achieve without differential taxation. Festival Enterprises, Inc. v. City of Pleasant Hill, 182 Cal.App.3d 960, 964 (1983).

Balancing the need to raise revenue against the rights of free speech, California courts twice have found admission taxes unconstitutional as applied solely to movie theaters. These courts have found that the cities' interest in raising revenue was not sufficiently compelling to justify discriminatory tax treatment of businesses engaged in protected speech. In Festival Enterprises,Inc. v. City of Pleasant Hill, 182 Cal.App.3d 960, 964 (1986), theater owners challenged the city's 5 percent tax on the admission price of sporting events, movie theaters, concerts, shows, museums, performances, displays and exhibitions. The admissions tax was one of three levied to raise money for street repairs. Although the ordinance applied to other entertainment businesses, theaters alone were affected, as they were the only taxable entities within the city.

The court found that the city's interest in raising revenue, while critical to the operation of any government, did not justify differential treatment of the theaters. The court reasoned that the city could raise revenue by taxing businesses generally, and that the operation of the theaters did not increase use of city services so as to require additional revenue. The court dismissed the city's argument that the tax was valid because it imposed a uniform rate for all businesses that charged an admissions fee, stating that the "gravamen of differential tax treatment upon protected activity is the threat that discriminatory taxes may be effectively used to censor unpopular expression." Festival Enterprises, 182 Cal.App.3d at 965. The court also rejected the city's argument that the tax was constitutional because it did not expressly designate theaters to bear the burden of the tax. Reasoning that the key factor in determining the constitutionality of taxing schemes is the practical operation of the tax, the court concluded that the effect of the tax was discriminatory. Id.

Faced with a similar challenge to the constitutionality of an admissions tax in United Artists Communications, Inc. v. City of Montclair, 209 Cal.App.3d 245 (1989), cert. denied, 493 U.S. 918 (1989), the court reached a similar conclusion. Like the Pleasant Hill tax, the Montclair admissions tax applied to a broad range of activities, from athletic events to theatrical performances. It also was levied to fund government services. Ninety percent of the tax's burden fell on movie theaters and adult bookstores. The court invalidated the admissions tax, finding that the tax fell disproportionately on these two types of businesses. The court reasoned that these businesses could

not avoid the tax, as could skating rinks, which could stop charging admission and raise skate rental fees, or nightclubs, which could drop admission fees and institute a minimum drink or dinner charge. Finally, the court reasoned that a statute challenged under the First Amendment must be tested by its operation and effect. Based on the discriminatory operation and effect of the admissions tax on theaters and bookstores, the court found the tax unconstitutional as applied to these businesses.

Based on these cases, governments must show a compelling reason for taxing businesses engaged in protected speech, if the impact of the tax disproportionately burdens these businesses. The need to raise revenue is not sufficient justification; nor does it matter that the tax applies to a range of entertainments and amusements. If the effect of the tax is to discriminate against businesses engaged in protected speech, the tax will violate the First Amendment.

CONCLUSION

The City may levy an admissions tax to fund government services, with monies deposited in the general fund, without voter ratification. However, if the effect of an admissions tax is to disproportionately burden businesses engaged in protected speech, then the tax may violate the First Amendment.

JOHN W. WITT, City Attorney
By
Stuart H. Swett
Senior Chief Deputy

SHS:CB:smm:160(x043.2)
ML-92-88

TOP
TOP