Fiscal Note & Local Impact Statement

127 th General Assembly of Ohio

Ohio Legislative Service Commission
77 South High Street, 9th Floor, Columbus, OH 43215-6136 ✧ Phone: (614) 466-3615
✧ *Internet Web Site:* http://www.lsc.state.oh.us/

BILL: **Sub. S.B. 16** DATE: **May 21, 2007**

STATUS: **As Passed by the House** SPONSOR: **By Initiative**

LOCAL IMPACT STATEMENT REQUIRED: **Yes**

CONTENTS: **Sexually oriented businesses**

State Fiscal Highlights

STATE FUND	FY 2007*	FY 2008	FUTURE YEARS
General Revenue Fund (GRF)			
Revenues	- 0 -	Potential minimal gain in court cost revenues; Potential losses from reduced personal income tax, sales tax, and corporation franchise tax	Potential minimal gain in court cost revenues; Potential losses from reduced personal income tax, sales tax, corporation franchise tax, and the commercial activity tax
Expenditures	- 0 -	(1) Potential increase, magnitude uncertain, for the Attorney General's legal drafting assistance; (2) Potential increase, magnitude uncertain, associated with indemnification payments	(1) Potential increase, magnitude uncertain, for the Attorney General's legal drafting assistance; (2) Potential increase, magnitude uncertain, associated with indemnification payments
Victims of Crime/Reparations Fund (Fund 402)			
Revenues	- 0 -	Potential minimal gain in court cost revenues	Potential minimal gain in court cost revenues
Expenditures	- 0 -	- 0 -	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2007 is July 1, 2006 – June 30, 2007.
* For the purposes of this fiscal analysis, it is assumed that any of the bill's state fiscal effects would occur sometime after FY 2007.

- ***Court cost revenues.*** The bill may produce a minimal revenue gain to the state's GRF and the Victims of Crime/Reparations Fund (Fund 402) from increased local collection of state court costs, as individuals may be convicted of violating the bill's misdemeanor prohibitions.

- ***Reduction in state tax revenues.*** The bill may decrease the number of sexually oriented businesses, and may reduce sales, receipts, and profits of the industry. Such an outcome would decrease state revenues from various tax sources, primarily the sales tax, the personal income tax, the commercial activity tax, and the corporation franchise

tax. Under current law, revenues from these taxes are distributed in various proportions to the GRF. The extent of the potential GRF revenue loss is uncertain.

- ***Office of the Attorney General.*** The Office of the Attorney General could experience some increase in workload if municipal corporations seek assistance in developing, formulating, and drafting an ordinance regarding the operation of adult entertainment establishments in their jurisdictions. Under current law, townships already have this authority. At the time of this writing, LSC fiscal staff has gathered no evidence indicating the potential number of municipal corporations that could request such assistance from the Office of the Attorney General if the bill were enacted.

- ***Indemnification.*** Predicting with any certainty the potential fiscal implications of the bill's indemnification provision is rather problematic. This is due to several variables, including, but not limited to, the number of jurisdictions that may develop such regulations with the assistance of the Attorney General, the number of potential civil actions that may be filed by affected sexually oriented businesses, and the rate of success of such suits. However, if one case is successfully challenged and a judgment is rendered against the jurisdiction, the state could experience an increase in expenditures exceeding minimal. For the purposes of this fiscal analysis, in excess of minimal means an estimated cost of more than $100,000 for the state per year. The source of state funds that would be used to make such payments is uncertain.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2007	FY 2008	FUTURE YEARS
Counties, Municipalities, and Townships (criminal justice systems)			
Revenues	Potential gain in court cost and fine revenues, magnitude uncertain	Potential gain in court cost and fine revenues, magnitude uncertain	Potential gain in court cost and fine revenues, magnitude uncertain
Expenditures	Potential increase in criminal justice system costs, magnitude uncertain	Potential increase in criminal justice system costs, magnitude uncertain	Potential increase in criminal justice system costs, magnitude uncertain
Counties, Municipalities, and School Districts (tax revenues)			
Revenues	Potential losses from reduced distributions to various local government funds from state taxes, magnitude uncertain	Potential losses from reduced distributions to various local government funds from state taxes, magnitude uncertain	Potential losses from reduced distributions to various local government funds from state taxes, magnitude uncertain
Expenditures	- 0 -	- 0 -	- 0 -

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- ***Local court cost and fine revenues.*** By creating the possibility for new criminal cases, the bill also creates the potential for additional court cost and fine revenues to be collected by local criminal justice systems statewide. The magnitude of the bill's potential relative to increasing local criminal justice system revenues is uncertain.

- ***Local criminal justice system expenditures.*** Theoretically, the expenditures of certain local criminal justice systems may increase, reflecting the additional costs to investigate, prosecute, adjudicate, and sanction individuals who violate the bill's regulations and prohibitions. The magnitude of those potential costs on any given local jurisdiction is likely to be a function of the number of affected businesses and the degree to which those businesses

violate the bill's regulations and prohibitions. As of this writing, the combination of those factors is rather problematic to determine.

- ***Tax revenues.*** The bill may potentially decrease revenues from distributions of various state taxes to local governments. The Local Government Revenue Assistance Fund receives 0.6% of revenues from the sales, personal income, and corporation franchise taxes. The Local Government Fund receives 4.2% of revenues from the sales, personal income, and corporation franchise taxes. The Library and Local Government Fund receives 5.7% of revenues from the personal income tax. The School District Tangible Property Tax Replacement Fund and the Local Government Tangible Property Tax Replacement Fund receive distributions from the commercial activity tax. The bill may also reduce local revenues from municipal income and profits taxes. These losses will depend on the location of businesses affected by the bill.

Detailed Fiscal Analysis

The bill, proposed by initiative,[1] contains several prohibitions relating to sexually oriented businesses. Specifically, the bill:

- Prohibits a sexually oriented business from remaining open between midnight and 6 a.m., unless the business is covered by a liquor permit that authorizes operation during those hours, in which case it may remain open until the hour specified in that permit if it does not conduct, offer, or allow sexually oriented entertainment activity in which the performers appear nude and makes a violation of the offense a misdemeanor of the first degree.

- Prohibits any patron of a sexually oriented business from knowingly touching any employee of the business who is nude or seminude and makes the violation a misdemeanor of the fourth or first degree depending on certain circumstances.

- Prohibits employees of the business who appear nude or seminude on the premises and while nude or seminude to knowingly touch a patron or another employee and makes a violation a misdemeanor of the fourth or first degree depending on certain circumstances.

- Provides that the state shall indemnify a township or a municipal corporation and its trustees from liability incurred in the enforcement of a resolution that is drafted in accordance with

[1] This bill was proposed by initiative. An initiative petition proposing a law must contain signatures of electors equal to 3% of the total votes cast in the last election for Governor. The petition must be filed with the Secretary of State at least ten days before a session of the General Assembly commences. If the General Assembly fails to act on the proposal within four months, fails to pass the proposal, or passes an amended version of the proposal, the proponents have 90 days to file a supplementary petition with the Secretary of State demanding that it be put on the ballot. The supplementary petition must contain additional signatures amounting to 3% of the total votes cast in the last election for governor. The proponents may include in the supplementary petition any amendments that were incorporated into the proposal by either or both houses of the General Assembly. The Secretary of State must submit the proposal to the electors at the next regular or general election. If the voters approve the proposal, it takes effect 30 days after the election and any different version that was passed by the General Assembly is invalidated. If the voters reject the proposal, any different version that was passed by the General Assembly becomes effective. The Governor may not veto a law that was proposed by petition and approved by the electors.

legal guidance provided by the Attorney General and that a court finds to be unconstitutional or otherwise legally defective.

- Permits the legislative authority of a municipal corporation to request the Attorney General to provide legal guidance and assistance in developing, formulating, and drafting an ordinance regarding the operation of adult entertainment establishments.

Regulation of sexually oriented businesses

The bill defines "sexually oriented business" as an adult bookstore or adult video store, an adult cabaret,[2] an adult motion picture theater, a sexual device shop, or a sexual encounter center.

The bill contains two primary offenses: (1) illegally operating a sexually oriented business, and (2) illegal sexually oriented activity in a sexually oriented business. The table below illustrates the penalties associated with these two offenses.

Sentences and Fines

Criminal Offense	Penalty	Fine	Sentence
(1) Illegally operating a sexually oriented business			
• All circumstances	Misdemeanor of the 1st degree	Maximum of $1,000	Up to 6 months in jail
(2) Illegal sexually oriented activity in a sexually oriented business			
• Involving touching of certain anatomical areas of certain individuals	Misdemeanor of the 1st degree	Maximum of $1,000	Up to 6 months in jail
• Involving touching of all other areas of certain individuals	Misdemeanor of the 4th degree	Maximum of $250	Up to 30 days in jail

In response to the bill, the owners, operators, and employees of sexually oriented businesses would presumably take one of two courses of action as follows:

(1) ***Compliance*.** Owners, operators, and employees of sexually oriented businesses could choose to comply fully with the bill's regulations. Arguably, compliance in many situations would negatively impact such businesses, specifically by limiting the nature and hours of operation. As such, it seems probable that some businesses may cease to exist, thus affecting the state and local tax base.

(2) ***Noncompliance*.** Owners, operators, and employees of sexually oriented businesses will opt to violate the bill's regulations and prohibitions. In this case, the violator(s) would presumably be arrested, successfully prosecuted, and sanctioned. The impact of noncompliance on any given local criminal justice system will be a function of the number

[2] An "adult cabaret" is a nightclub, bar, juice bar, restaurant, bottle club, or other similar commercial establishment, regardless of whether alcoholic beverages are served, that regularly features persons who appear in a state of nudity or seminudity.

of affected businesses and the degree to which those businesses violate the bill's regulations and prohibitions.

At the time of this writing, it is rather problematic to predict the relative levels of compliance and noncompliance with the bill's regulations and prohibitions in any given local jurisdiction.

Indemnification

The bill also provides that the state shall indemnify a township or a municipal corporation and its trustees from liability incurred in the enforcement of a resolution that is drafted in accordance with legal guidance provided by the Attorney General and that a court finds to be unconstitutional or otherwise legally defective. The bill permits the legislative authority of a municipal corporation to request the Attorney General to provide legal guidance and assistance in developing, formulating, and drafting an ordinance regarding the operation of adult entertainment establishments.

State fiscal effects

Court cost revenues

The bill may produce a revenue gain to the state's GRF and the Victims of Crime/Reparations Fund (Fund 402) from increased local collection of state court costs, as individuals may be convicted of violating the bill's misdemeanor prohibitions. For a misdemeanor offense, the state court cost totals $24, with $15 of that amount being credited to the GRF and the remaining $9 being credited to Fund 402. As of this writing, it does not appear that the potential gain in state court revenues would exceed minimal. For the purposes of this fiscal analysis, a minimal revenue gain means an estimated increase of less than $100,000 per year for either state fund.

Tax revenues

The bill may decrease the number of sexually oriented businesses in the state. For businesses that remain open, the bill potentially decreases sales, receipts, and profits in the industry. The bill may also reduce the income of employees and self-employed individuals working in the industry. Reductions in employment, earnings, sales, receipts, and profits would then decrease state revenues from various tax sources, primarily the sales tax, the personal income tax, the commercial activity tax, and the corporation franchise tax (CFT). Under current law, revenues from these taxes are distributed in various proportions to the GRF. As no reliable data on sales and profits of the sexually oriented industry is readily available to LSC fiscal staff, the magnitude of the potential loss in state revenues is, as of this writing, rather problematic to determine.

Office of the Attorney General

The Office of the Attorney General could experience some increase in workload if municipal corporations seek assistance in developing, formulating, and drafting an ordinance regarding the operation of adult entertainment establishments in their jurisdictions. Under current law, townships already have this authority. At the time of this writing, LSC fiscal staff has gathered no evidence

indicating the potential number of municipal corporations that could request such assistance from the Office of the Attorney General if the bill were enacted.

Paying of judgments

By allowing for the indemnification of certain townships and municipal corporations, it is possible the state may experience some increase in expenditures associated with the claims brought on behalf of affected jurisdictions. The bill mandates that the state shall indemnify these jurisdictions if two conditions are met: (1) the ordinance was drafted in accordance with legal guidance provided by the Attorney General, and (2) a court finds it to be unconstitutional or otherwise legally defective. If this occurs, the state is obligated to pay the affected jurisdiction any judgment in, or amount negotiated in settlement of, any civil action arising from the enforcement of the ordinance. The state shall not indemnify these jurisdictions until all appeals have been exhausted or the action has otherwise been finally resolved.

Predicting with any certainty the potential fiscal implications of this provision of the bill is rather problematic. This is due to several variables, including, but not limited to, the number of jurisdictions that may develop such regulations with the assistance of the Attorney General, the number of potential civil actions that may be filed by affected sexually oriented businesses, and the rate of success of such suits. However, if one case is successfully challenged and a judgment is rendered against the jurisdiction, the state could experience an increase in expenditures exceeding minimal. For the purposes of this fiscal analysis, in excess of minimal means an estimated cost of more than $100,000 for the state per year. The source of state funds that would be used to make such payments is uncertain.

Local fiscal effects

Local criminal justice system expenditures

Presumably, violator(s) of the bill's regulations and prohibitions will be arrested, successfully prosecuted, and sanctioned. The fiscal effect of that outcome is theoretically that the affected local criminal justice system's expenditures increase, reflecting the additional costs to investigate, prosecute, adjudicate, and sanction such offenders. The magnitude of those potential costs on any given local jurisdiction is likely to be a function of the number of affected businesses and the degree to which those businesses violate the bill's regulations and prohibitions. As of this writing, the combination of those factors is rather problematic to determine. Thus, whether those potential costs for certain local criminal justice systems could exceed minimal is uncertain. For the purposes of this fiscal analysis, a minimal expenditure increase means an estimated annual cost of no more than $5,000 for any affected local criminal justice system.

Local court cost and fine revenues

By creating the possibility for new criminal cases, the bill also creates the potential for additional court cost and fine revenues to be collected by local criminal justice systems statewide. As noted, the magnitude of the bill's potential relative to increasing local criminal justice system expenditures is uncertain. Similarly, the potential related gain in court cost and fine revenues is uncertain. This means that whether that potential gain in revenues could exceed minimal is uncertain as well. For the purposes

of this fiscal analysis, a minimal revenue gain means an estimated annual increase of no more than $5,000 for any affected local jurisdiction.

Local tax revenues

Revenue from the state's corporate activity tax (CAT) is credited to the CAT Receipts Fund in the state treasury for distribution to the GRF, the School District Tangible Property Tax Replacement Fund (SDRF), and the Local Government Tangible Property Tax Replacement Fund (LGRF). Amended Substitute House Bill 66 of the 126th General Assembly created the SDRF and the LGRF, and distributions to the two funds were to replace moneys lost due to the elimination of the tax on most tangible personal property. For the FY 2008-2009 biennium, receipts from the CAT are allocated only to the SDRF and LGRF, so any decrease in CAT receipts reduces revenue to these funds.

Under current law, revenue from the individual income tax is distributed to the GRF (89.5%), the Library and Local Government Support Fund (5.7%), the Local Government Fund (4.2%), and the Local Government Revenue Assistance Fund (0.6%). Revenue from the sales tax is distributed to the GRF (95.2%), the LGF (4.2%), and the LGRAF (0.6%). If the bill negatively impacts sexually oriented businesses, then there is presumably some reduction in moneys that might otherwise have been distributed to local governments.

No meaningful revenue loss to local governments will occur from distribution of receipts from the corporate franchise tax (CFT). Revenue from the CFT is distributed to the GRF (95.2%), the LGF (4.2%), and the LGRAF (0.6%). However, the previously noted Am. Sub. H.B. 66 eliminated over five years the CFT for nonfinancial corporations. In FYs 2008 and 2009, nonfinancial corporations will pay 40% and 20%, respectively, of their full tax liability. The tax is eliminated in FY 2010.

The bill also potentially creates revenue loss from reduced receipts from the permissive county and transit authority sales taxes, and the municipal income and profit taxes. Those local revenue losses will depend on the location of the sexually oriented businesses.

LSC fiscal staff: Jamie L. Doskocil, Senior Budget Analyst
Jean Botomogno, Senior Economist

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