

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Jones-Sawyer Analyst: Deatherage Bill Number: AB 2291
Related Bills: See Legislative History Telephone: 845-4783 Introduced Date: February 21, 2014
Attorney: Bruce Langston Sponsor: _____

SUBJECT: Internet Poker Consumer Protection Act of 2014

SUMMARY

This bill would establish a licensing and regulatory framework to allow licensees located in California to offer online poker games to authorized players located within the state.
This analysis will address the bill only as it impacts the department and its programs, operations, and state income tax revenue.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to authorize, implement, and create a legal system for intrastate Internet gambling in order to protect Californians who gamble online, allow state law enforcement to ensure consumer protection, and keep the revenues generated from Internet gambling in California.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective and operative immediately upon enactment.

ANALYSIS

FEDERAL/STATE LAW

Income Tax and Withholding

Existing state law imposes tax on the income earned by individuals, estates, trusts, and certain business entities. Tax is imposed on the entire taxable income of residents of California and upon the taxable income of nonresidents derived from sources within California. The tax for individuals is computed on a graduated scale at rates ranging from 1 percent to 12.3 percent. Current state law requires the Franchise Tax Board (FTB) on an annual basis to provide the Employment Development Department with wage withholding tables to be used by employers to

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withhold taxes on wages paid to their employees. The tables are based on the estimated amount of tax due on the wages paid by the employer. Legislation enacted in 2009 requires the amount determined for the withholding tables to be increased by 10 percent. In addition, employers required to withhold tax on supplemental wages can use a method that applies a fixed rate to the supplemental wage amount. This rate is 6.6 percent for supplemental wages other than stock options and bonus payments. The rate of withholding for stock options and bonus payments is 10.23 percent.

Taxpayers are required to make estimated tax payments if the amount of taxes withheld or otherwise available for a taxable year is less than the amount due. Penalties are imposed if the estimated taxes are underpaid.

State and federal laws require withholding for tax payments on gambling winnings in excess of specified amounts.

Gaming

Under federal law, the Unlawful Internet Gambling Enforcement Act of 2006 (Unlawful Gambling Act), prohibits a person engaged in the business of betting or wagering from accepting methods of payment, including credit cards, electronic fund transfers, and checks in connection with the participation in "unlawful Internet gambling." Unlawful Internet gambling is defined as a bet or wager that knowingly involves the use of the Internet where such a bet is unlawful under any applicable federal or state law in the state or tribal lands in which the bet or wager is initiated, received, or otherwise made. The Unlawful Gambling Act exempts certain transactions from this prohibition, including bets or wagers that are initiated and received exclusively within a single state and the bet or wager is expressly authorized and played in accordance with the laws of that state. The state law must include age and location verification requirements and data security standards designed to prevent access to minors and persons located outside of that state. The law additionally stipulates that the bet or wager may not violate four separate federal laws: the Interstate Horseracing Act, the Professional and Amateur Sports Protection Act, the Gambling Devices Transportation Act, and the Indian Gambling Regulatory Act.

Several bills¹ have been introduced in Congress to license and regulate Internet gaming within the past few years. None have been enacted into law to date.

The Gambling Control Act of 1997 (Gambling Control Act) established the California Gambling Control Commission (Commission) to regulate legal gaming in California and the Bureau of Gambling Control within the Department of Justice to investigate and enforce controlled gambling activities in California. The Gambling Control Act prohibits gambling in a city or county that does not have an ordinance governing certain aspects of the operation of gambling establishments, including the "hours of operation" of gambling establishments.

¹[H.R. 2666](#) (2013-2014), [H.R. 2366](#) (2011-2012), [H.R. 1174](#) (2011-2012), [H.R. 2230](#) (2011-2012)

The California Constitution permits Indian tribes to conduct and operate slot machines, lottery games, and banked and percentage card games on Indian land if (1) the Governor and an Indian tribe reach agreement on a compact; (2) the Legislature approves the compact; and (3) the federal government approves the compact. There are currently 70 active Tribal-State Gaming Compacts.

THIS BILL

This bill would allow eligible entities that meet specific qualifications and background requirements to submit an application to the Commission for nontransferable renewable licenses for up to 10 years to operate online "poker" in the State of California. The Commission would regulate the gambling activities and the Department of Justice would have related investigatory and enforcement duties.

This bill would allow the FTB to collect income tax revenues from registered players participating in Internet poker activity. The funds held in a registered player's account could be used to remit tax proceeds due and owing from a registered player to the FTB.

The FTB would be required to submit a request for costs needed to implement this bill for the upcoming fiscal year to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate and Assembly Committees on Governmental Organization, and the Department of Finance by March 31 of the preceding fiscal year. A justification of these costs would be required with each submission.

This bill would create the Internet Poker Fund and the Unlawful Gambling Enforcement Fund. An applicant to become a licensee would be required to submit an application and an unspecified amount of application deposit funds to be deposited into Internet Poker Fund, to cover the reasonably anticipated costs to complete the necessary background investigation and evaluation of the applicant's suitability. The Unlawful Gambling Enforcement Fund would be established to deposit a portion of recovered civil penalties from enforcing the prohibitions and protections as detailed in this bill. The Unlawful Gambling Enforcement Fund would ensure continuing resources for law enforcement charged with enforcing these prohibitions and protections.

Once licensed and before collection of fees from registered players, a licensee must remit \$5,000,000 for a one-time license fee for deposit in the General Fund. When this license fee is depleted, the licensee would be required to transfer a minimum of 5 percent of its gross revenue to the Treasurer on a quarterly basis, and the Treasurer would be required to transfer that money to the Controller to be deposited into the Internet Poker Fund. The one-time license fee would be credited against quarterly transfers that are based on 5 percent of gross revenue.

This bill would require the state to opt out of, and decline to opt into, any federal framework for Internet gambling.

This bill contains a nonseverability provision that provides if any provision of this act or its application to any person or circumstances is held invalid; the entire act shall be invalid.

The bill would define various terms including the following:

- "Authorized Internet poker game" means any of several card games, duly authorized by the Commission and played on an Internet poker Web site, that meets all of the following criteria:
 - Commonly understood to be a "poker game" that is legal under state law as of the effective date of this chapter, including but not limited to Hold 'em, Stud, Omaha, and Lowball.
 - Not a percentage game or banked game in which a licensee, player, or combination of players operates as the bank or house at any time during the course of the game.
 - Played by individual players against one another, and never by a field of players against one player, including, but not limited to Paid Gow poker, Three Card power, and other poker variants with similar rules.
- "Bet" means the placement of a wager in a game.
- "Card room" means a gambling establishment, as defined in the Business and Professions Code Section.²
- "Commission" means the California Gambling Control Commission.
- "Eligible entity" includes only:
 - A card room operated pursuant to the Business and Professions Code³ whose owner or owners have been authorized, subject to oversight by, and in good standing with the applicable state regulatory authorities; or
 - A federally recognized California Indian tribe that operates a gaming facility pursuant to a facility license issued in accordance with a tribal gaming ordinance approved by the Chair of the National Indian Gaming Commission and that is eligible to conduct real-money poker at that facility.

An eligible entity must have operated its gaming facility for at least five years immediately preceding its application to secure a license to operate an Internet poker Web site and is in good standing during that time period with the applicable federal, state, and tribal regulatory authorities.

- "Gambling" means to deal, operate, carry on, conduct, maintain, or expose for play any games for money.
- "Land-based gaming facility" means a card room⁴ or a casino operated by a federally recognized Indian tribe on Indian land in California.

² [Business and Professions Code Chapter 5, Section 19805\(o\).](#)

³ [Business and Professions Code Chapter 5.](#)

⁴ [Business and Professions Code Chapter 5.](#)

- "Licensee" means an eligible entity licensed to offer the play of authorized Internet poker games to registered players on an intrastate Internet poker Web site.
- "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity, including any federally recognized California Indian tribe, or an entity that is wholly owned by the tribe.
- "Registered player" means a player who has registered with a licensee to play authorized Internet poker games on the licensee's intrastate Internet poker Web site.
- "Tribe" means a federally recognized California Indian tribe, including, but not limited to, the governing body of that tribe or any entity that is wholly owned by the tribe.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill lacks administrative details necessary to implement the bill and determine its impacts to the department's systems, forms, and processes. The bill is silent on the following issues:

- A funding mechanism for the FTB's start-up and on-going costs to administer the provisions of this bill. Absence of a funding mechanism could delay implementation or require diversion of resources from existing revenue generating workloads.
- A definition of the phrase "tax proceeds due and owing."
- A definition of "wager". "Bet" and "wager" are used interchangeably throughout the bill and the definition of "bet" includes the term "wager".
- Whether and to what extent the FTB could use a player's personally identifiable information.
- Whether withholding penalties would be applicable.
- Whether and to what extent amounts withheld would be available to be offset against non-tax debts that the department is authorized to collect. Additionally, if the author intends that withheld amounts be available to offset child support obligations, this bill must be amended to reauthorize the department to collect on behalf of the Department of Child Support Services.

The author may wish to amend this bill to provide clarity on these issues and ensure consistency with the author's intent.

The funds held in a registered player's account could be used to remit tax proceeds due and owing from a registered player to the FTB; however, the bill language lacks a mandatory withholding provision. The language states that the registered player would determine the amount to be withheld from winnings for federal or state income tax purposes and that the licensee would provide the FTB with all personally identifiable information about registered players as necessary to assist them in fulfilling their obligations. The Commission would determine which state agencies require online access to the registered players' information. For ease of administration, the author may wish to consider amending this bill to specify that payments received by players under this act would be subject to withholding and reporting requirements under existing provisions of the Revenue and Taxation Code.⁵

This bill would require the licensee to retain for one year after they are created all books, records, documents, financial information, and financial reports, including the information used to prepare the annual forms electronically submitted to the FTB. Destruction of documentation prior to the expiration of the statute of limitations could result in disputes among taxpayers, licensed poker room operators, and the department. It is recommended that the author amend the bill to specify a retention period that is consistent with existing retention requirements for similar data.

TECHNICAL CONSIDERATIONS

This bill should be amended to include reference to a taxpayer identification number. On page 28, line 6, the phrase "or taxpayer identification number" should be inserted after the phrase "social security number" appears.

This bill would create a new chapter in the Business and Professions Code for Internet poker; however, it states that the existing provisions found in the Gambling Control Act (Chapter 5) do not apply. Yet throughout the language, the bill refers to definitions and references that are found in Chapter 5.

The bill uses "person" and "player" where the appropriate word is "individual" or maybe "natural person" (person is defined in the bill and includes "natural person" and a number of entities. "Player" is undefined).

LEGISLATIVE HISTORY

SB 1366 (Correa, 2013/2014) would establish a framework to authorize intrastate Internet poker and require the Department of Justice, in consultation with the California Gambling Control Commission, to adopt regulations governing the intrastate play of poker games on the Internet. SB 1366 has been referred to the Senate Committee on Governmental Organization.

SB 51 (Wright, 2013/2014) would have established a framework to authorize intrastate Internet poker and to require the Department of Justice, in consultation with the California Gambling Control Commission, to adopt regulations governing the intrastate play of poker games on the Internet. SB 51 failed to pass out of the Senate Committee on Governmental Organization.

⁵ [Revenue and Taxation Code Article 5.](#)

SB 678 (Correa, 2013/2014) was substantially similar to this bill. SB 678 failed to pass out of the Senate Committee on Governmental Organization.

SB 40 (Correa, 2011/2012) would have established a framework to authorize intrastate Internet poker and required the Department of Justice, in consultation with the California Gambling Control Commission, to adopt regulations governing the intrastate play of poker games on the Internet. SB 40 failed to pass out of the Senate Committee on Governmental Organization.

SB 45 (Wright, 2011/2012) would have established a framework authorizing intrastate Internet gambling and required the Department of Justice, in consultation with the California Gambling Control Commission, to adopt regulations governing intrastate gambling on the Internet. SB 45 failed to pass out of the Senate Committee on Governmental Organization.

SB 1463 (Wright, 2011/2012) was substantially similar to this bill. SB 1463 was held in the Senate Committee on Governmental Organization.

AB 293 (Mendoza, Chapter 233, Statutes of 2009), among other things, prohibited gambling enterprises from cashing checks drawn against any federal, state, or county fund.

SB 1485 (Wright, 2009/2010) was substantially similar to SB 45. SB 1485 failed to pass out of the Senate Committee on Government Organization.

AB 1385 (Battin, et al., Chapter 874, Statutes of 1999) clarified the Governor's role in entering into memoranda of understanding with Indian tribes and ratified 57 Tribal-State Gaming Compacts.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not allow Internet gambling. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

However, *Delaware, Nevada, and New Jersey* laws provide for similar treatment for Internet gambling as would be allowed by this bill. In June 2012, *Delaware* enacted the Delaware Gaming Competitiveness Act of 2012 that allows online slot machine play and casino games such as blackjack and poker accessible through casino websites and controlled centrally by the Delaware Lottery Office. Also in June 2012, *Nevada* became the first state to issue Internet gaming licenses. *New Jersey* passed legislation that legalized online gambling in February 2013.

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved, but anticipates the costs to be significant.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 2291 As Introduced February 21, 2014 Assumed Enactment After June 30, 2014 (\$ in Millions)		
2014-15	2015-16	2016-17
+ \$7.1	+ \$12.1	+ \$12.7

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that this bill would establish a framework for California entities to offer intrastate Internet poker play, generate significant revenue in California as a result of licensing and ongoing operating fees, and provide oversight and regulate intrastate Internet poker play.

Opponents: Some may argue that this bill may increase the number of problem and addicted gamblers and may result in a decrease in revenues to the tribal casinos.

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