

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Correa Analyst: Deatherage Bill Number: SB 1366
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 do the following:

- Establish a licensing and regulatory framework to allow licensees located in California to offer online poker games to authorized players located within the state,
Require the Franchise Tax Board (FTB) to create a form to allow licensed poker room operators to report players' winnings electronically to the FTB, and
Require the gaming operator to withhold state income tax from gambling winnings.

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.

Table with 2 columns: Board Position and Executive Officer/Date. Board positions include S, SA, N, NA, O, OUA, NP, NAR. Executive Officer: Selvi Stanislaus, Date: 5/15/14.

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 FTB on an annual basis to provide the Employment Development Department with wage withholding tables to be used by employers to 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 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.

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 California Gambling Control Commission (Commission) for licenses for up to 10 years to operate online "poker" in the State of California. The Commission and the Department of Justice would oversee three types of licenses: platform operator licenses, poker room operator licenses, and service provider licenses.

Licensed poker room operators would be required to withhold income tax in an amount equal to 5 percent of a registered player's tournament winnings if the amount of winnings, after deduction of the tournament charge, is in excess of \$600 and if those winnings are also at least 300 times the tournament charge. Mandatory tax withholding would be determined on a tournament-by-tournament basis. Licensed poker room operators would be required to remit the amount of money withheld from a registered player's tournament winnings to the FTB directly from the registered player's account. 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 publish a form that would be utilized and filed electronically on an annual basis by licensed poker room operators to report the information concerning income tax revenues from registered players to the state. This form would include a registered player's name, social security number, the total amount deposited into a player's gaming account during the year, the amounts of a player's total winnings and losses during the year, and the amounts withheld by the licensed poker room operator during the year for purposes of federal or state income tax, and whether the registered player opened or closed his or her online account during the year.

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

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 provided with each submission.

State agencies would have the authority to adopt rules to implement the duties that would be required under this bill. As such, the FTB may adopt rules to collect and process the taxes withheld, collected, or remitted by licensed poker room operators and gamers.

This bill would create the Internet Poker Licensing Fund and the Internet Poker 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 Licensing Fund, to cover the reasonably anticipated costs to complete the necessary background investigation and evaluation of the applicant's suitability.

This bill would establish separate license procedures for an application that is a federally recognized Indian tribe.

Once licensed and before collection of fees from registered players, poker room operators must remit \$10,000,000 for a one-time license fee for deposit in the General Fund. When this license fee is depleted, the poker room operator would be required to transfer a minimum of 10 percent of its gross revenue to the Treasurer on a monthly 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 monthly transfers based on the 10 percent of gross revenue for the first years of operation.

The bill would define various terms including the following:

- "Authorized poker platform" means a software system that has been approved by the regulatory agency to manage and operate the play and presentation of authorized games.
- "Authorized poker room" means a virtual cardroom on the Internet with one or more virtual card tables in which authorized placers can play authorized games.
- "Commission" means the California Gambling Control Commission.
- "Gamble" or "gambling" means the placing of a bet or something of value at risk on the chance that the outcome of game or event over which the player does not have total control will occur and that will result in the winning of a prize for correctly predicting the outcome.
- "Game" means a contest in which players may win or lose depending on skill, chance or a combination thereof, depending on the rules of play.
- "Gross revenues" means the total amount of moneys paid by players to the operator to participate in authorized games before deducting the cost of operating those activities except for fees to intermediate and payment processing fees.

- “Person” means a natural person, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, including a tribal government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity.
- "Poker" means a card game that is played by two or more players who bet and compete against each other on the cards dealt to them out of a common deck of cards, not banked by either the house or by a player, in which success over time is influenced by the skill of the player, and wagers of one player are often designed to affect the decisions of another player in the game.
- "Service provider" means a person that, under a service provider license, does either of the following:
 - Supplies good or services to an authorized platform operator or poker room operator to enable the operator to operate that platform or poker room.
 - Provides a gaming product or service to a licensee for use in an authorized game, including intermediary services.
- "Tournament" means a competition in which players play a series of games to decide the winner.

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 withholding requirement and percentage on non-tournament play.
- The due dates a licensed poker room operator transfers withheld amounts to the FTB.
- A definition of the phrase “tax proceeds due and owing.”
- 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 bill defines "good standing" as a person who has not had a California gaming license or determination of suitability suspended or revoked by a final decision of an agency that has issued that license or has been issued a final order by a court of competent jurisdiction to cease conducting gaming activities. However, the bill also uses the phrase "good standing" in different contexts throughout the bill. For example, a nontribal licensing applicant is required to be a California resident or an entity organized in California, domiciled in California, and in "good standing" with the Secretary of State and the FTB, and subject to auditing, enforcement of the terms of the license, and state taxation. The author may wish to amend the bill to clarify the various meanings of "good standing" that could lead to disputes with taxpayers and would complicate the administration of this bill.

This bill would establish a withholding and reporting regime that appears to be inconsistent with current rules, practices, procedures, and penalties under the Revenue and Taxation Code (R&TC). For example, the licensed poker room operator would be required to withhold 5 percent of a registered player's winnings, whereas the existing withholding rate is generally 7 percent. Additionally, this bill lacks detail on the timing of submitting withheld amounts to the FTB. 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 R&TC and removing the withholding and reporting provisions from this bill.

This bill would require the licensed poker room operator 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 61, line 36, the phrase "or taxpayer identification number" should be inserted after the phrase "social security number" appears because not all taxpayers use social security numbers.

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).

The bill requires reports for players that had accounts for a portion of a "taxable year." For consistency and ease of administration it is recommended that the report be based on a calendar year and include all players that had an open account during that time.

LEGISLATIVE HISTORY

AB 2291 (Jones-Sawyer, 2013/2014) would establish 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. AB 2291 is pending before the Assembly.

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.

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.

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 Competiveness 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 anticipate the costs to be significant.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 1366 As Introduced February 21, 2014 Assumed Enactment After June 30, 2014 (\$ in Millions)		
2014-15	2015-16	2016-17
+ \$14	+ \$13	+ \$13

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.

LEGISLATIVE STAFF CONTACT

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