

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Wright Analyst: Diane Deatherage Bill Number: SB 51
Related Bills: See Legislative History Telephone: 845-4783 Introduced Date: December 19, 2012
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Internet Gambling Consumer Protection and Public-Private Partnership Act of 2013/California Gambling Control Commission in Consultation with Department of Justice, Treasurer, and Franchise Tax Board to Report to Legislature Annually on State's Effort to Meet Policy Goals

SUMMARY

This bill would do the following:

- Allow the playing of and wagering on Internet poker within California,
- Require the Franchise Tax Board (FTB) to create a form to allow poker gaming 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 interstate 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.

Board Position:

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Executive Officer

Date

Selvi Stanislaus

03/04/13

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 (EDD) 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.

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. None have been enacted into law.

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

The Gambling Control Act of 1997 established the California Gambling Control Commission to regulate legal gaming in California and the Bureau of Gambling Control within the Department of Justice (Department) to investigate and enforce controlled gambling activities in California. It 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 background requirements to submit an application to the California Gambling Control Commission (Commission) for a 5-year license to operate online gaming website(s) offering only the play of "poker" in the State of California. The Commission and the Department would oversee the licensees, which would be required to regulate the Internet gaming sites and 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. The licensee would also 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 players 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 annually that would be utilized by licensees to report the winnings of its members 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 licensee during the year for purposes of federal or state income tax, and whether the registered player opened or closed his online account during the year. This form would be filed electronically by the licensee with 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 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, and/or remitted by licensees and gamers.

This bill would create the Internet Gambling Fund. Upon initial submission, an applicant is required to submit an application and a deposit between the amounts of \$1,000,000 and \$5,000,000, to cover the reasonably anticipated costs to complete necessary background investigation and evaluation of the applicant's suitability. Once licensed and before collection of fees from registered players, the licensee remits a one-time license fee of \$30,000,000. In exchange for the state allowing a licensee to do business in California, the licensee 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 Gambling Fund. The one-time license fee would be credited against monthly transfers based on the 10 percent of gross revenue for the first five years of operation. The bill would define various terms including the following:

- "Commission" means the California Gambling Control Commission.
- "Gambling" means to deal, operate, carry on, conduct, maintain, or expose for play any game for money.
- "Game" means any gambling game.
- "Gross revenues" means the total amount of money paid to a licensee pursuant to activities authorized under the chapter that would be created by this bill. "Gross revenues" would not mean player wagers or deposits.
- "Licensee" means an entity licensed to offer the play of authorized games to registered players on an intrastate Internet website.
- "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.
- "Poker" means a card game that is played by two or more players who wager 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.
- "Registered player" means a player who has registered with a licensee to play authorized games.
- "Tournament" means a department-approved competition in which registered players play a series of authorized games to decide the winner.
- "Tournament winnings" means the amount of any prize awarded to a registered player in a tournament.

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 the FTB to redirect resources from existing General Fund revenue generating workload priorities.
- A withholding percentage on non-tournament play.
- The dates a licensee transfers withheld amounts to the FTB.
- A definition of the phrase "tax proceeds due and owing."
- The purpose for what the FTB could use a player's personally identifiable information.
- If withholding penalties would be applicable.
- If the 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.

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 form electronically submitted to the FTB. Destruction of documentation prior to the expiration of the statute of limitations could result in disputes among taxpayers, licensees, 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.

LEGISLATIVE HISTORY

SB 40 (Correa, 2011/2012) proposed to establish a framework to authorize intrastate Internet poker and to require the Department, 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 requiring the Department, 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 nearly identical to this bill. SB 1463 was held in the Senate Committee on Governmental Organization.

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

AB 293 (Mendoza, Chapter 233, Statutes of 2009) prohibited gambling enterprises from cashing checks drawn against any federal, state, or county fund, and deleted a requirement that copies of dishonored or uncollectible checks be sent to the FTB.

AB 2026 (Levine, 2007/2008) directed the California Gambling Control Commission, in conjunction with the Department, to perform a study and report its findings back to the Legislature regarding authorizing intrastate Internet poker. After a favorable vote on the Assembly floor, the bill was amended in the Senate to authorize the intrastate play of various Internet poker games to be offered by licensed gambling establishments registered with the Commission. The bill was amended again in the Senate Committee on Governmental Organization to become an Internet poker "study" bill. It was later gutted and became a state property issue.

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.

SB 8 (Lockyer, Chapter 867, Statutes of 1997) prohibited the ownership or operation of a gaming club without first obtaining a valid registration from the Attorney General and created the California Gambling Control Act to regulate authorized gaming rooms and tribal gaming facilities within California.

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* and *Nevada* provide 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.

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 51 Internet Gambling Consumer Protection & Public-Private Partnership Act of 2013 As Introduced December 19, 2012 For Taxable Years Beginning On or After January 1, 2014 Enactment Assumed After June 30, 2013 (\$ in Millions)		
2014-15	2015-16	2016-17
+\$29	+\$33	+\$36

* This estimate does not include any revenue attributable to fees imposed on licensees' gross revenues.

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

ARGUMENTS

Proponents: This bill would establish a framework for California entities to offer intrastate Internet poker play and generate significant revenue in California as a result of licensing and ongoing operating fees. This bill would provide oversight and regulate the intrastate Internet websites, as opposed to, offshore operators that are not regulated by United States authorities.

Opponents: This bill may increase the number of problem/addicted gamblers and may result in a decrease in revenues to the Indian casinos.

LEGISLATIVE STAFF CONTACT

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