

**ANALYSIS OF AMENDED BILL**

Author:	<u>Gray and Jones-Sawyer</u>	Analyst:	<u>Diane Deatherage</u>	Bill Number:	<u>AB 2863</u>
Related Bills:	<u>See Legislative History</u>	Telephone:	<u>845-4783</u>	Introduced Date:	<u>February 19, 2016</u>
		Attorney:	<u>Bruce Langston</u>	Amended Date:	<u>April 20, 2016</u>
			Sponsor		

**SUBJECT:** Internet Poker Consumer Protection Act of 2016

**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.

**Summary of Amendments**

As introduced on February 19, 2016, the bill would create the Internet Poker Consumer Protection Act of 2016 in the Business and Professions Code.

The April 20, 2016, amendments modified the operative date of the bill.

This is the department's first analysis of the bill.

**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 immediately upon enactment and operative when criteria are established by statute to address involvement in Internet betting prior to the state's authorization of Internet poker pursuant to Chapter 5.2 of Division 8 of the Business and Professions Code.

**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 13.3 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 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. 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 bills<sup>1</sup> have been introduced in Congress to license and regulate Internet gaming within the past few years. There are also two bills to amend the federal Interstate Wire Act of 1961 to provide that the prohibition against transmission of wagering information applies to all types of gambling activities and if enacted would prohibit Internet gambling.<sup>2</sup> None have been enacted into law to date.

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<sup>1</sup>[H.R. 3491](#) (2013-2014), [H.R. 2666](#) (2013-2014), [H.R. 2366](#) (2011-2012), [H.R. 1174](#) (2011-2012), [H.R. 2230](#) (2011-2012).

<sup>2</sup> [H.R. 707](#) (2015-2016) and [S. 1668](#) (2015-2016).

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.

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 72 active Tribal-State Gaming Compacts.<sup>3</sup>

### **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 seven 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.

The FTB would be allowed to collect income tax revenues from registered players participating in Internet poker activity. Each registered player would determine the amount of withholding from their winnings for federal or state income tax purposes. 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.

Personally identifiable information of registered players would be required to be shared with state agencies, including but not limited to, the FTB, Department of Justice, Commission, and Department of Child Support Services as necessary to assist them in fulfilling their obligations.

A licensed operator would be required to provide current and accurate documentation to state agencies, including the FTB, as well as facilitate the collection of state personal income tax from registered players.

This bill would create the Internet Poker Fund, the Unlawful Gambling Enforcement Fund and the California Horse Racing Internet Poker Account. 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

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<sup>3</sup> The State of California has signed and ratified Tribal-State Gaming Compacts with 72 Tribes and there are Secretarial Procedures in effect with Rincon Band of Luiseno Mission Indians of the Rincon Reservation.

Gambling Enforcement Fund would ensure continuing resources for law enforcement charged with enforcing these prohibitions and protections. The first \$60,000,000, collected from licensed operators' one-time license deposits and the quarterly percentage of licensed operators' gross gaming revenues, would fund horse racing and jockey related expenditures, and fair and exposition accounts, as specified.

Once licensed and before collection of fees from registered players, a licensee would be required to remit an unspecified amount 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 an unspecified 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 the unspecified percent of gross revenue.

This bill would specify that certain provisions related to what is permissible as an Internet gambling game and eligibility for a gaming license are nonseverable and if any of those provisions are held invalid, the entire act would 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 Department of Justice and played on an authorized poker Web site, that meet the definition of poker as specified in this bill.
- "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.<sup>4</sup>
- "Commission" means the California Gambling Control Commission.
- "Eligible entity" includes both:
  - A card room operated pursuant to the Business and Professions Code<sup>5</sup> whose owner or owners have been authorized, subject to oversight by, and in good standing with the applicable state regulatory authorities.
  - 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.

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<sup>4</sup> [Business and Professions Code Chapter 5, Section 19805\(o\)](#).

<sup>5</sup> [Business and Professions Code Chapter 5](#).

An eligible entity must have operated its land-based 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. An eligible entity may be a combination of tribes and card rooms if each group independently satisfies the requirements of the Internet Poker Consumer Protection Act of 2016.

- "Gambling" means to deal, operate, carry on, conduct, maintain, or expose for play any games for money.
- "Land-based gaming facility" means a card room,<sup>6</sup> a casino operated by a federally recognized Indian tribe on Indian land in California, or a horse racetrack.
- "Licensed operator" means an eligible entity licensed as specified to offer the play of authorized Internet poker games to registered players on an authorized poker Web site.
- "Licensed service provider" means a person licensed as specified to provide goods or services to a licensed operator for use in the operation of an authorized poker Web site.
- "Licensee" means a licensed operator or licensed service provider.
- "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 licensed operator to play authorized Internet poker games on the licensed operator's authorized 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

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. 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.

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<sup>6</sup> [Business and Professions Code Chapter 5.](#)

- The requirement that players be located in California while playing online poker would include California residents as well as visitors and non-residents. If this is more broadly defined than the author intends, this bill should be amended.
- 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 requirements and 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 authorize the Department of Child Support Services to have the ability to collect from registered players.
- Whether and under what circumstances funds in a registered player's account could be used to satisfy tax liabilities unrelated to Internet gambling.

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. For ease of administration, the author may wish to consider amending this bill to specify that payments received by players would be subject to withholding and reporting requirements under existing provisions of the Revenue and Taxation Code.<sup>7</sup>

This bill would require the licensee to make electronically available for 180 days and archive and retain all books, records, documents, financial information, and financial reports, including the information used to prepare the annual forms electronically submitted to the FTB for two years after they are created. 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.

The bill contains provisions that make it harder to obtain records and information (page 35, lines 15 through 32) requiring a court order on a clear and convincing basis which is a high threshold and will preclude the use of the FTB's administrative subpoenas.

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<sup>7</sup> [Revenue and Taxation Code, Part 10.2, Div. 2, Article 5](#) (Commencing with section 18661.).

This bill uses a phrase that is undefined, i.e., "governmental third party." The absence of definition to clarify this phrase could lead to disputes with taxpayers and would complicate the administration of this credit.

The operative date language lacks specifics on the criteria that would need to be established by statute, who would be responsible for the determination, and how the FTB would be made aware of the required criteria being established. Without the specifics, the bill would be difficult for the department to administer compliance and enforcement. If this is not the author's intent, the bill should be amended.

## **TECHNICAL CONSIDERATIONS**

This bill should be amended to include reference to a taxpayer identification number. On page 35, line 1, the phrase "or taxpayer identification number" should be inserted after the phrase "social security number."

## **LEGISLATIVE HISTORY**

AB 9 (Gatto, 2015/2016) was substantially similar to this bill. AB 9 failed to pass out of the Assembly by the constitutional deadline.

AB 167 (Jones-Sawyer, 2015/2016) was similar to this bill. AB 167 failed to pass out of the Assembly Committee on Governmental Organization.

AB 2291 (Jones-Sawyer, 2013/2014) was substantially similar to this bill. AB 2291 failed to pass out of the Assembly 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.

SB 678 (Correa, 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 678 failed to pass out of the Senate Committee on Governmental Organization.

SB 1366 (Correa, 2013/2014) 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 1366 has been referred to 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) 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 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) 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 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 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 anticipates the costs to be significant.

## ECONOMIC IMPACT

### Revenue Estimate

This bill would result in the following revenue gain:

Estimated Revenue Impact of AB 2863 As Amended April 20, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
\$0	+ \$10.0	+ \$20.0

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

### Revenue Discussion:

It is estimated that this bill could result in an increase of revenue from two sources: (1) Licensed operators and service providers and (2) personal income taxpayers.

(1) Licensed operators and service providers:

Currently, the only authorized gambling operators in California are federally recognized Indian tribes, card rooms, and horse racing associations operating as both C and S corporations. Based on Indian tribal gambling studies, it is estimated that tribal gaming revenue will increase by \$2.4 billion per year as a result of the legalization of online poker. However, because most Indian gaming activity income is not taxable, it is estimated only 1 percent of the increase could be distributed to tribal members not living on a reservation, and would be subject to the personal income tax. The increase to taxable income for tribal members is estimated be \$28 million in 2017.

Based on the income of California taxpayers in the gambling industry, it is estimated that the legalization of online poker for nontribal licensed operators and service providers could increase S corporation card room income by \$110 million per year, and C corporation card room income by \$15 million per year in 2017. After applying a marginal tax rate of 1.5 percent for S corporations and 5.5 percent for C corporations, revenue is reduced by 50 percent to reflect the assumption that online gambling won't be operational until July 1, 2017, and by an additional 90 percent to reflect a 10 percent customer phase-in. This slower phase-in is applied as a result of anticipated technical and regulatory complications. This results in revenue gain of \$125,000 in 2017. In 2018, it is estimated that the customer phase-in will reach 30 percent resulting in revenue of \$800,000, and 60 percent in 2019 resulting in revenue of \$1.7 million.

(2) Personal Income Taxpayers:

Analysis of California and federal tax gambling data found that net gambling winnings for California personal income taxpayers in 2013 to be \$2.1 billion. According to data from various gambling studies, it is estimated that 11 percent of these winnings are from online poker gaming, and legalization of online poker is expected to triple reported winnings. It is assumed that due to federal banking restrictions, some banks will not allow credit cards to be used for Internet gaming so the estimate is reduced by 30 percent. In 2017, it is estimated online poker net winnings would be \$550 million. Estimated S corporation shareholder income from online licensed operators and service providers of \$110 million and online poker income received by Indian tribal members located off the reservation of \$28 million are added, resulting in total estimated income from online poker of \$650 million. Applying a six percent average tax rate results in revenue of \$41 million.

In 2017, the potential revenue is reduced by 50 percent to reflect the assumption that online gambling won't be operational until July 1, 2017, and by an additional 90 percent to reflect a 10 percent player phase-in. This slower phase-in is applied as a result of anticipated technical and regulatory complications; the revenue is estimated to be \$2.1 million in 2017. In 2018, it is estimated that the player phase-in will reach 30 percent resulting in revenue of \$13 million. In 2019, it is estimated that the player phase-in will be 60 percent resulting in revenue of \$23 million.

The tax year estimates for licensed operators and personal income taxpayers are converted to fiscal year estimates as reflected in the table above.

**SUPPORT/OPPOSITION<sup>8</sup>**

Support:

Bicycle Casino  
California Authority of Racing Fairs  
California Teamsters Public Affairs Council  
California Thoroughbred Breeders Association  
California Thoroughbred Trainers  
Commerce Casino  
Del Mar Thoroughbred Club  
Hawaiian Gardens Casino  
Jockeys Guild  
Lake Elsinore Casino  
Los Alamitos Racing Association  
Morongo Band of Mission Indians  
Napa Valley Casino  
Pala Band of Mission Indians  
Poker Players Alliance

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<sup>8</sup> Assembly Governmental Organization Committee analysis, dated April 26, 2016.

Amaya Inc. / PokerStars  
Rincon Band of Luiseño Indians  
San Manuel Band of Mission Indians  
SEIU California  
Stones Gambling Hall  
Thoroughbred Owners of California  
United Auburn Indian Community

Opposition:

Coalition to Stop Internet Gambling

### **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 tribal casino revenues.

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