

SUMMARY ANALYSIS OF AMENDED BILL

Gray and
Author: Jones-Sawyer Analyst: Diane Deatherage Bill Number: AB 2863
Related Bills: See Prior Telephone: 845-4783 Amended Date: August 18, 2016
Analysis Attorney: Bruce Langston 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

The August 18, 2016, amendments modified several provisions, including removal of the automatic repeal date, within the Business and Professions Code.

Except for the "This Bill" section, the remainder of the department's analysis of the bill as amended on June 27, 2016, still applies. The "Implementation Considerations," "Technical Considerations," "Fiscal Impact," and "Economic Impact" sections have been restated for convenience.

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 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 Franchise Tax Board (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 the 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. Each fiscal year, up to \$60,000,000¹ collected from licensed operators' one-time license deposits and the quarterly-deposited ten percent 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 licensed operator would be required to remit \$12,500,000 for a one-time license fee for deposit in the General Fund. When half of the one-time license deposit fee (or \$6,250,000) is depleted, the licensed operator would be required to transfer quarterly ten percent of its gross gaming revenues to the Treasurer for deposit into the General Fund, subject to Business and Professions Code section 19619.8. Half of the one-time license fee would be credited against the quarterly transfers that are based on ten percent of gross gaming revenue, as specified in the bill.

Each licensed operator would also pay a regulatory fee, to be deposited in the Internet Poker Fund, in an amount to be determined by the Commission, for the reasonable costs of license oversight, consumer protection, state regulation, problem gambling programs, and other related purposes, determined on a pro-rata basis depending on the number of licensed operators in the state.

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.

This bill would authorize poker games to be played via the Internet and specifies that no other game would be authorized to be played via the Internet.

¹ 85 percent, in an amount not to exceed \$57 million in the California Horse Racing Internet Poker Account, and five (5) percent, in an amount not to exceed \$3 million, to the State Treasury to the credit of the Fair and Exposition Fund. The remaining 10 percent would be deposited into the General Fund.

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 enterprise, as defined in the Business and Professions Code.²
- “Commission” means the California Gambling Control Commission.
- “Eligible entity” includes both:
 - 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.
 - 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 land-based gaming facility for at least three years immediately preceding its application to secure a license to operate an Internet poker Web site and must have been in good standing during that time period with the applicable federal, state, and tribal regulatory authorities. An incorporation or other change in legal form or ownership during the five years immediately preceding its license application that did not alter the beneficial ownership of the card room would not disqualify an otherwise licensure-eligible card room. 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 gambling establishment,⁴ or a casino operated by a federally recognized Indian tribe on Indian land in California.
- “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, as determined by the Commission, to a licensed operator for use in the operation of an authorized poker Web site.
- “Licensee” means a licensed operator, licensed service provider, or licensed marketing affiliate.

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

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

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

- “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.
- 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 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.⁵

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 45, lines 28 through 40 and page 46, lines 1 through 5) 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.

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

TECHNICAL CONSIDERATIONS

This bill should be amended to include reference to a taxpayer identification number. On page 41, line 3, the phrase "or taxpayer identification number" should be inserted after the phrase "social security number."

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 on August 18, 2016 For Taxable Years Beginning On or After January 1, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
\$0	+ \$6.8	+ \$17

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

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 to 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 would increase S corporation card room income by \$13 million in the first year, and C corporation card room income would also increase by \$10 million. After applying a marginal tax rate of 1.5 percent for S corporations and 5.5 percent for C corporations, revenue is reduced by 75 percent to reflect the assumption that online gambling won't be operational until September 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 \$20,000 in 2017. In 2018, it is estimated that the customer phase-in will reach 25 percent resulting in revenue of \$ 375,000 and 60 percent in 2019 resulting in revenue of \$825,000.

(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 35 percent. In 2017, it is estimated online poker net winnings would be \$540 million. Estimated S Corporation shareholder income from online licensed operators and service providers of \$13 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 \$582 million. Applying a six percent average tax rate results in revenue of \$35 million.

In 2017, the potential revenue is reduced by 75 percent to reflect the assumption that online gambling won't be operational until September 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 \$900,000 in 2017. In 2018, it is estimated that the player phase-in will reach 25 percent resulting in revenue of \$9.8 million. In 2019, it is estimated that the player phase-in will be 60 percent resulting in revenue of \$21 million.

The tax year estimates for licensed operators and personal income taxpayers are converted to fiscal-year estimates and rounded to arrive at the amounts reflected in the above table.

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