

ANALYSIS OF ORIGINAL BILL

Author: Gatto Analyst: Diane Deatherage Bill Number: AB 9
 See Legislative
 Related Bills: History Telephone: 845-4783 Introduced Date: December 1, 2014
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	Internet Poker Consumer Protection Act of 2015
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SUMMARY

This bill would establish a licensing and regulatory framework to allow licensed operators 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.

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.

Board Position:	Executive Officer	Date
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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. 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.² 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.

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.

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

² [H.R. 4301](#) (2013-2014) and [S. 2159](#) (2013-2014).

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. 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.

Under this bill, 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.

Under this bill, the FTB:

- could direct a licensed operator to suspend or revoke registered players' accounts;
- would be required to report actual or suspected violations of the Internet Poker Consumer Protection Act of 2015 to the Department of Justice;
- may enter into information sharing agreements with other regulatory and law enforcement agencies to assist in performing its duties;
- could be consulted by the Commission during the preparation of the annual report to the Legislature; and
- 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.

Under this bill, a licensed operator would be required to make all financial records available to state agencies, as well as facilitate the collection of personal income tax from registered players.

This bill would create the Internet Poker Fund and the Unlawful Gambling Enforcement Fund. For an eligible entity to become a licensed operator, that eligible entity 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 for an operator license for intrastate Internet gambling. 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 licensed operator must remit \$5,000,000 for a one-time license fee for deposit in the General Fund. When this license fee is depleted, the licensed operator 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 provide that if a federal law authorizing Internet gambling is enacted and provides that states may elect to be governed by its provisions, such election by the state could only be through an affirmative legislative act.

The bill would require that a licensed operator³ do the following in person at a land-based gaming facility operated by the licensed operator or at a satellite service center:

- verify that the person is 21 years of age or older and attempt to match the name, address, and date of birth provided by the person using a database of government records, prior to registering a person as a registered player or permitting a person to play;
- receive a registered player's initial deposit; and
- process a registered player's withdrawal if greater than an unspecified amount or if the amount of cumulative withdrawals in a seven-day period is greater than an unspecified amount.

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 Commission and played on an authorized poker Web site, that meet the definition of poker as specified by this section.
- "Authorized poker Web site" means a Web site on which authorized Internet poker games are offered for play by a licensed operator pursuant to this chapter.
- "Bet" means the placement of a wager in a game.
- "Card room" means a gambling enterprise, as defined in section 19805(m) of the Business and Professions Code Section.⁴
- "Commission" means the California Gambling Control Commission.

³ Whether directly or through the actions of its licensed service provides or a satellite service center.

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

- "Eligible entity" includes both of the following:
 - A card room operated pursuant to the Business and Professions Code⁵ 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 three 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.
- "Gross gaming 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 marketing affiliates and payment processing fees. Gross gaming revenues does not include player deposits or amounts bet, except to the extent any portion of those bets are retained as fees by the operator, discounts on goods or services, rebates or promotional awards, discounts or stakes provided to players, or revenues from nongaming sources, such as from food, beverages, souvenirs, advertising, clothing, and other nongaming sources.
- "Land-based gaming facility" means a card room⁶ 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 to a licensed operator for use in the operation of an authorized poker Web site.
- "Licensee" means a licensed operator, licensed service provider, or registered or licensed marketing affiliate.
- "Marketing affiliate" means any person other than the licensed operator, or a subaffiliate of that person who, for a fee or other consideration, provides or refers players to the licensed operator's authorized poker Web site.
- "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision,

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

⁶ [Business and Professions Code Chapter 5.](#)

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.

- "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.
- "Promotion" includes a jackpot, high hand bonuses, royal flush bonus, aces cracked, splash pot, or other promotional prize that is appended to the play of an authorized Internet poker game, provided that the promotion is approved by the Commission and does not create a banked or illegal game.
- "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.
- "Satellite service center" means a facility operated pursuant to this bill.
- "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.
- 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.
- 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.

- Whether and under what circumstances could the funds in a registered player's account 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 licensed operator 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 under this act would be subject to withholding and reporting requirements under existing provisions of the Revenue and Taxation Code.⁷

This bill would require the licensed 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 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

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.

A period (.) is needed at the end of the sentence on page 20, line 34.

This bill should be amended to include reference to a taxpayer identification number. On page 45, line 4, the phrase "or taxpayer identification number" should be inserted after the phrase "social security number."

It appears that the references to subdivision (d) of Section 19990.403 on page 52, line 13 and page 66, line 5 may be inaccurate. Subdivision (d) is a provision that relates to proprietary information and the two references to that subdivision relate to the payment of fees.

LEGISLATIVE HISTORY

AB 167 (Jones-Sawyer, 2015/2016) is substantially similar to this bill. AB 167 is currently in the Assembly Committee on Governmental Organization.

⁷ [Revenue and Taxation Code Article 5.](#)

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 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 failed to pass out of 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.

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 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 currently 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:

This bill would result in the following revenue gain.

Estimated Revenue Impact of AB 9 As Introduced December 1, 2014 Assumed Enactment After June 30, 2015 (\$ in Millions)		
2016-17	2017-18	2018-19
+ \$29	+ \$47	+ \$51

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 and card rooms operating as both C and S corporations. Based on Indian tribal gambling studies, it is estimated that tribal gaming revenue will increase by \$2.3 billion per year as a result of the legalization of online poker. However, because most distributed Indian gaming activity income is not taxable, it is estimated only 1 percent of the increase could be attributable to tribal members not living on a reservation, and would be subject to the personal income tax. After applying the Department of Finance's personal income tax growth rates, this revenue is estimated to be \$32 million in 2016.

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 \$140 million per year, and C corporation card room income by \$25 million per year in 2016.⁸ 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, 2016, and by an additional 70 percent to reflect a 30 percent customer phase-in. This slower phase-in is applied as a result of the bill's in-person player requirements. This would result in estimated revenue of \$500,000. In 2017, it is estimated that the customer phase-in would reach 75 percent resulting in revenue of \$3 million. In 2018, it is estimated that the customer phase-in would be 100 percent resulting in revenue of \$4 million.

(2) Personal Income Taxpayers:

Analysis of California and federal tax gambling data found that net gambling winnings for California personal income taxpayers in 2012 to be \$2.2 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 the in-person deposit and withdrawal requirements would deter most casual gamblers, and the estimate is reduced by 35 percent. After applying the Department of Finance's personal income tax growth rates, it is estimated online poker net winnings would be \$570 million in 2016. Estimated S Corporation shareholder income from online licensed operators and service providers of \$140 million and online poker income received by Indian tribal members located off the reservation of \$32 million are added, resulting in total income from online poker of \$740 million. Applying a 6 percent average tax rate results in revenue of \$44 million.

In 2016, the potential revenue is reduced by 50 percent to reflect the assumption that online gambling won't be operational until July 1, 2016, and by an additional 70 percent to reflect a 30 percent customer phase-in. This slower phase-in is applied as a result of the bill's in-person player requirements and revenue is estimated to be \$7 million in 2016. In 2017, it is estimated that the customer phase-in would reach 75 percent resulting in revenue of \$35 million. In 2018, it is estimated that the customer phase-in would be 100 percent resulting in revenue of \$50 million.

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

⁸ Reviewed New Jersey online gaming activity for similarity and applied information learned from their legalization.

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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