

November 12, 2003

Hon. Bill Lockyer  
Attorney General  
1300 I Street, 17<sup>th</sup> Floor  
Sacramento, California 95814

Attention: Ms. Tricia Knight  
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative entitled "Homeland Security Act of 2004" (File No. SA2003RF0041, Amendment #1-S), which proposes changes to the State Constitution and various state statutes.

## Background

The Constitution and state law limit the types of legal gambling that can occur in California. For instance, wagering on horse races and specified games in licensed card rooms are allowed. In addition, Indian tribes which have entered into tribal-state gaming compacts are authorized to operate casino-style gaming—including slot machines and various "banked" games (such as twenty-one and craps). In banked games, the operator has a stake in the outcome of the game.

**Card Rooms.** The state allows card rooms to conduct certain "non-banked" card games. These are games where the card room operator has no stake in the outcome of the game. The players play against each other and pay the card room a fee for the use of the facilities. Typical card games include draw poker, seven-card stud, and poker pai gow. State law specifically prohibits certain games—such as twenty-one.

Current law limits the expansion of both the number of card rooms and the size of existing card rooms until January 2010. Card room ownership is limited to private entities, with publicly traded companies prohibited. There are currently about 100 licensed card rooms in California. Currently, the state and local governments collect licensing fees for card rooms in California.

**Horse Racing.** The California Horse Racing Board (CHRB) is responsible for regulating horse racing in California. The CHRB issues licenses to racing associations that then lease tracks for the duration of racing meets. In California there are a total of

six privately owned race tracks, nine racing fairs, and 20 simulcast-only facilities. (These latter facilities do not have live racing; instead they allow betting on televised races occurring elsewhere in the world.) The state receives revenue from the horse racing activities from license fees, penalties, and the collection of approximately 1 percent of the gross amount wagered at any licensed event.

**Gambling on Indian Land.** The federal Indian Gaming Regulatory Act of 1988 and state law govern gambling operation on Indian land. Those tribes that enter a tribal-state compact may operate slot machines and engage in banked card games, such as twenty-one. Currently, 64 tribes have tribal-state gaming compacts and operate 51 casinos.

**Gambling Regulation in California.** Under current law, state regulation of gambling, with the exception of activities regulated by CHRB, is the responsibility of the California Gambling Control Commission (CGCC) and the Division of Gambling Control in the Attorney General’s Office. These entities are responsible for the licensure of owners and most employees of gaming establishments, investigating suspected violations of the Gambling Control Act, and assessing fines for violations of state law. The CGCC is also charged with regulation of the tribal gaming compacts. Local governments approve card rooms in their jurisdiction, as well as establish the hours of operation, number of tables, and wagering limits. The regulatory activities of these agencies are mostly funded by licensing and penalty fees collected from gaming establishments.

**Major Provisions of the Initiative**

This measure expands the types of gambling activities allowed in California. Specifically, it authorizes banked games and slot machines at specified gaming establishments.

**Slot Machines.** The measure allows an entity licensed by the CHRB to operate up to 5,000 slot machines. It also allows licensed card rooms to operate a number of slot machines, depending on the number of tables in operation as noted in Figure 1.

<b>Figure 1 Authorized Number of Slot Machines for Card Rooms</b>	
<b>Number of Authorized Tables</b>	<b>Slot Machines Per Table</b>
1 to 10	5
11 to 60	10
More than 60	20

Based on the current number of licensed card room tables in operation and the number of licenses issued by the CHRB, the measure would authorize up to 200,000 slot machines. The number of slot machines authorized would fluctuate with any change in the number of licenses issued by the CHRB or the number of licensed card room tables in operation.

*Card Room Expansion.* The measure makes many changes regarding licensed card rooms in California. The measure expands the types of card games allowed at the establishments to include some banked games—such as twenty-one. It also eliminates the current restrictions on both the expansion of existing or new card rooms. The measure also authorizes publicly traded corporations and intermediary companies to qualify for a gambling license.

*Tax on Gambling Establishments.* The measure establishes a 15 percent tax on the annual gross revenue of gambling establishments. Gross revenue is defined as the gross amount wagered less money returned to the players. A credit would be allowed for any tax paid to a local government, up to the amount of tax paid to the local government during 2001-02. The measure exempts activities that are licensed by the CHRB from this new tax.

*Distribution of New Revenues.* The measure specifies that each year half of the additional revenues, up to \$1 billion, would be provided to the Office of Emergency Services for the purpose of making grants to local governments to assist them in preventing or responding to acts of terrorism or natural disasters. The funds would be distributed to local governments and could not replace funds already being used for the same purpose. The measure allows the costs of administering the grants to be funded from these revenues. The balance of funds would be transferred annually to the state's General Fund.

*Elimination of the CGCC.* This measure eliminates the CGCC and transfers most of its responsibilities to the Attorney General's Office. The measure, however, does not address the tribal-state gaming compact regulatory activities currently conducted by the CGCC.

## **Fiscal Effect**

The measure would have the following fiscal effects:

*Increased Revenues From New Gaming Tax.* Increased revenues from the 15 percent tax would depend on a number of factors, including the extent to which:

- New slot machines and card games were added at gaming establishments.

- There was an increase in (1) the number of CHRB licensees or (2) the number or size of card rooms.

Over time, as entities expanded gambling, revenues could grow to the high hundreds of millions of dollars. As specified by the measure, half of these funds would be used for local government grants and the other half would be deposited in the state's General Fund. These increased revenues would be partially offset to the extent that any new gaming activities replaced other forms of gaming currently available in California, such as the lottery and horse racing.

Given the likely increase in General Fund revenues, the measure would affect the amount of funds the state is required to provide K-14 schools under the constitutional provisions of Proposition 98. The measure could increase the state's funding obligation to K-14 schools in the near term by around 50 percent of the increase in state General Fund revenues.

*Increased Taxable Economic Activity.* This measure would increase the level of taxable economic activity in the state to the extent it:

- Diverted gambling activity and associated spending from other states (particularly Nevada) to California.
- Shifted gambling from tribal gaming activities to entities covered by the measure (since much tribal activity is exempt from state taxation).

In the longer term, the increase of taxable economic activity could result in potentially significant increases in various state and local tax revenues (such as property, sales, and income taxes).

*State Regulatory Costs.* The measure could result in increased state gaming regulation costs. The magnitude of these costs would depend on the extent of increased gambling but could reach up to several tens of millions of dollars annually. Licensing fees have typically covered these costs.

*Local Government Costs.* If the measure significantly expanded gambling, local governments could experience unknown, but potentially significant increases in costs associated with gambling, such as for law enforcement and infrastructure.

## Summary

This measure would have the following major fiscal effects:

- Over time, potential increased revenues in the high hundreds of millions of dollars annually, depending on the expansion of gambling. Revenues would be shared by the state and local governments.

- Potentially significant increase in various tax revenues to state and local governments in the longer term from increased taxable economic activity in the state.

Sincerely,

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Elizabeth G. Hill  
Legislative Analyst

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Steve Peace  
Director of Finance