

June 24, 2015

Authorizing Online Poker In California: Issues For Consideration

LEGISLATIVE ANALYST'S OFFICE

Presented to:
Assembly Governmental Organization Committee
Hon. Adam Gray, Chair





Federal Law Allows States to Authorize Intrastate Online Gambling

- ☑ Under the Federal Unlawful Internet Gambling Enforcement Act (UIGEA) of 2006, it is generally unlawful to place or receive gambling bets through the Internet.
- ☑ However, UIGEA allows states to authorize online, intrastate gambling under certain conditions. For example, the type of bet or wager must be authorized by state law and cannot violate certain federal laws. In addition, rules and regulations must be adopted to prevent minors and nonstate residents from participating in online gambling.
- ☑ In recent years, there have been various bills introduced in Congress to legalize online gambling across all states, which would likely impact the revenues that states could generate from intrastate, online gambling.
- ☑ Currently, Nevada, Delaware, and New Jersey have launched intrastate, online gambling.



Issue: Who Could Offer Online Poker?

- Authorization to Provide Online Poker.** The Legislature would need to determine who in the state would be authorized to offer online poker. The Legislature could choose to permit certain existing gambling industries to offer online poker (such as tribal gaming, cardrooms, and horse racing). Currently, the only industry that is authorized to offer some form of online gambling is the horse racing industry. Alternatively, the Legislature could allow new entities (such as private businesses) to offer online poker.
- Licensing Requirements.** The Legislature would also want to consider specifying licensing requirements (such as minimum qualifications) to ensure that only those entities with a certain level of expertise or reputation are licensed to operate online poker in California. For example, entities currently interested in participating in online poker have expressed concern about whether website operators that previously violated UIGEA would be allowed to participate in a legal online poker market.
- Number of Websites.** The Legislature would also need to consider the number of websites that would be permitted to operate in California. Although the existence of multiple legal poker websites could promote competition, having too many sites could result in each site not having sufficient players to facilitate poker games.



Issue: How Would Online Poker Be Regulated?

- Regulating Body.** Depending on who is authorized to offer online poker, the Legislature would need to designate an entity to regulate online poker in the state. Options include establishing a new state regulatory entity or utilizing existing regulatory entities (such as the California Gambling Control Commission and the Bureau of Gambling Control at the Department of Justice).

- Level of Oversight.** The Legislature would also need to determine the level of oversight desired. This could include adopting specific statutory requirements (such as requiring certain player protection activities) or a general framework that would provide guidance to the regulatory entity as it promulgates regulations.

- Costs of Regulation.** The regulation of online poker would result in increased state costs—both onetime and ongoing. The magnitude of these would depend primarily on the level of regulation provided and how such regulation is implemented. The Legislature would need to determine how such regulatory costs would be funded, such as from licensing fees or revenue generated from online poker.



Issue: Would Online Poker Be Taxed?



State Tax Revenues

- Providers and players of online poker would be subject to existing corporate and income tax requirements.
- The Legislature could choose to establish additional taxes on online poker. Currently, the other states that offer online gaming require a share of the overall net or gross revenues from operators of legal websites.



Sources of State Revenues From Online Poker

- **Redirecting Wagering From Illegal Websites.** Several studies estimate that illegal websites receive roughly \$300 million to \$400 million in gross revenue from Californians participating in online poker. While it is not known how many current California players would switch from illegal websites, these potential gambling activities could generate new revenues for the state.
- **Generating More Wagering.** Revenue generated from (1) existing players betting more than they otherwise would or (2) individuals that currently do not play online poker would be offset, to an unknown extent, by a reduction in existing state revenues. This is because individuals would generally spend less consuming other goods and services because more of their income would be spent on online gambling.



Issue: What Factors Would Impact State Revenues From Online Poker?



Specific State Share of “Gross Revenues”

- To the extent the state required a share of gross revenues from legal website operators, the specific portion required would impact how much the state generated.
- One goal could be to maximize the benefit from these activities to the state. On the other hand, if the state were to require too large a share, such operators may not retain sufficient funds to effectively compete with the operators of illegal websites.



Reporting of Winnings for Tax Purposes

- Currently, players using illegal websites have little incentive to report gambling winnings for tax purposes. The state could require that legal websites report such information to the state to make it easier to collect income taxes on net winnings. However, this could deter some players from using legal websites.



Legal Issues Regarding Tribal Payments

- Currently, certain tribes are required in their compacts with the state to make payments to various state accounts (such as the state General Fund). Such compacts also contain provisions limiting the state’s ability to authorize certain types of games that could compete with tribal casinos. Legal concerns have been raised whether poker websites would violate such provisions. If such concerns were upheld in court, tribes could stop making payments.
- The Legislature will want to work closely with the Office of Legislative Counsel to assess these risks as it considers proposals in this area.



Issue: What Factors Would Impact State Revenues From Online Poker?

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Level of Player Participation

- **Games Offered.** Legal poker websites would have to compete with existing illegal websites that have little or no limits on the types of games offered.
- **Costs to Play.** If the cost of playing on legal poker websites was greater than the cost of playing on illegal websites, due to taxes and fees paid by the players, there could be a fiscal disincentive to play and wager similar amounts on legal sites.
- **Security and Regulation.** Unlike illegal poker websites, the legal websites would be able to provide players with a greater sense of security and comfort. However, it is not clear what specific steps individuals in California would need to take to be able to play on legal poker websites. If these requirements were extensive, however, they could be a barrier to player participation.



Operator Costs

- **Costs of Regulation.** Operators might ultimately choose not to participate in California if the state requires too much revenue (such as from the percentage of gross revenues or licensing fees), thereby reducing profitability.
- **Costs to Obtain or Retain Players.** Operators would likely incur marketing costs to drive players to legal websites and encourage them to wager. Additionally, many existing illegal websites offer financial incentives to retain players—such as bonuses to players that can only be collected after playing a predetermined time. This could make it more difficult for new California online websites to capture a share of the market in the near term. However, the state could also allow for similar incentives.



How Have Other States Dealt With These Issues?

- Types of Games.** Nevada began offering online poker in April 2013. Delaware and New Jersey began offering a variety of online games in November 2013, including poker, blackjack, roulette, and slots.
- Regulatory Authority.** Nevada and New Jersey divide regulatory, licensing, enforcement, and adjudicatory responsibilities between two separate state entities. In contrast, a single state entity has sole responsibility for regulating online gaming in Delaware.
- Operators.** Nevada and New Jersey both restrict the issuance of operator licenses to casinos or resort hotels that already possess certain gaming licenses that allow them to operate within the state. New Jersey also requires that nearly all associated personnel and equipment be housed within its Atlantic City casinos.
- Number of Websites.** Nevada currently has two websites, while New Jersey has at least a dozen distinct websites. The State of Delaware operates online gaming websites through its three racetrack casinos.
- State Tax Revenues.** All three states require that operators pay a certain percentage of their gross revenues to the state. Each state reports that less revenue has been generated than initially projected. For example, New Jersey initially anticipated revenues of \$160 million to \$180 million. In 2014, that state collected about \$19 million in state tax revenues.