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September 26, 1997

Hon. Daniel E. Lungren
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Rosemary Calderon

Dear Attorney General Lungren:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative constitutional amendment entitled the "Gaming Control Act" (File No. SA 97 RF 0025). The measure amends the California Constitution to authorize certain types of casino-style gaming and wagering, opens up card room ownership to certain publicly traded corporations, and provides for state oversight of the gambling industry. The measure establishes a California Gaming Control Commission and a separate Division of Gambling Control within the Department of Justice. As Section 9005 directs, our review addresses the potential effects of the measure on state and local government revenues and costs.

BACKGROUND

Under existing law, card games of skill, not of chance, are allowed to be played in card rooms that are approved and licensed by local jurisdictions. These card rooms also must be registered with the Attorney General's Gaming Registration Program. (Legislation currently before the Governor [SB 8, Lockyer] would establish a California Gambling Control Commission, create a Division of Gambling Control within the Department of Justice, and provide for the statewide regulation of legal gambling.)

Legalized Gambling and Wagering

Legalized gambling in card rooms is limited to games of skill where players bet against each other and pay the club a fee per hand or per time period. These so called "controlled" games include all forms of poker (draw, 7-card stud, Texas hold-em, high-low, and low-ball) and most Asian games (pai gow, panguingue). Existing law prohibits games of chance and wagering that comprise what is commonly referred to as casino-style gambling (such as roulette, craps, blackjack, and slot machines), backline wagering (where nonplayers bet on the outcome of players' hands), and progressive jackpots (where part of each cardgame's "pot" of winnings is carried over to successive games).

Currently, there is no state or local regulation of Indian gaming in tribal casinos.

Regulation

Under current law, local jurisdictions have control over card room regulation and taxation. Local ordinances set hours of operation, table size and number, and wagering limits. The Attorney General is responsible for background investigations, financial statements review, and license approval.

State law governing card room establishment and expansion depends on whether legalized gambling existed in a community prior to 1984. A majority vote of the electorate of a community is needed to establish clubs in those communities that did not permit gambling prior to 1984. In communities that allowed gambling prior to 1984, new or expanded card rooms can be approved by the local governing body, without a vote of the people. However, Chapter 387, Statutes of 1995 (SB 100, Maddy and Lockyer), placed a three-year moratorium on new and expanded card rooms effective January 1, 1996. The moratorium will be lifted January 1, 1999, unless a later statute enacted before that date establishes a comprehensive regulatory scheme under the jurisdiction of a gaming control commission. The proposed initiative would fulfill that requirement and thus lift the moratorium. (Should SB 8 become law it would extend the January 1, 1999 moratorium until January 1, 2001.)

Current state law allows corporations licensed to conduct horse racing and simulcast wagering to operate only one gaming club in the state and the gaming club must be located on the racetrack premises.

Taxation and Fees

Taxation of gambling revenue varies according to jurisdiction. The most common forms of local taxation on legalized gambling are: (1) business license taxes based on a sliding scale of gross receipts and (2) flat per table fees. The percentage of gross revenues that local jurisdictions currently receive from card rooms varies from 2 percent to 15 percent. A few jurisdictions do not tax gambling revenues.

PROPOSAL

This measure would authorize new games and wagering. Specifically, the measure would legalize (1) slot machines in the City of Palm Springs (Riverside County) and (2) certain other casino-style games and betting throughout the state. This measure also would allow those corporations licensed to conduct horse racing a total of three gaming club licenses and only one club need be located on the racetrack premises.

To regulate legalized gambling, the measure would establish a five-member California Gaming Control Commission (commission) and create a Division of Gambling Control (division) in the Department of Justice, which would replace the existing Gaming Registration Program. The measure also would levy a new state licensing fee on card rooms and a state tax on gross revenue from video gaming machines in the City of Palm Springs. (Senate Bill 8 also would establish a licensing fee on card rooms.)

The measure would become effective immediately upon approval of the electorate. The Legislature could amend the provisions of the measure, except the limitations placed on gambling and the effective date of the measure, to further its purposes.

The measure does not address Indian gaming. Existing federal law (the Indian Gaming Regulatory Act of 1988), however, authorizes Indian tribes in any state to operate any gambling games that are otherwise legal in the state for any purpose, subject to a negotiated agreement with the state. Thus, the expanded games and wagering authorized under the measure could also be allowed at Indian gaming establishments. Currently, several issues regarding gaming on Indian lands are in litigation.

Legalized Gambling and Wagering

This measure would legalize three new classes of controlled games and wagering: (1) California-style gaming, (2) progressive jackpots, and (3) backline wagering. California-style gaming, defined as video slot or video card machines, (1) would be allowed only in the City of Palm Springs, where voters passed an ordinance in Novem-

ber 1995 approving the establishment of three card rooms; and (2) would be limited to 5,000 machines.

Regulation

This measure would not preempt local government control over card rooms. It would, however, establish state regulatory authority over gaming. The commission, with the investigatory and technical assistance of the division, would be responsible for card room licensing and gambling regulation enforcement. Card room owners, operators, and investors; gambling equipment manufacturers and distributors; and gambling enterprise employees would be subject to annual licensing by the commission. (The provisions contained in SB 8 provide essentially the same regulation, licensing, and enforcement.)

The measure would create a Gaming Control Commission and thereby repeal the three-year moratorium on card rooms established by Chapter 387. In place of the moratorium, the measure would require a two-thirds vote of the electorate of the community to increase the existing number of tables (as of January 1, 1997) by 25 percent or more. (The moratorium established by SB 8 would be repealed by this measure.)

Fees, Fines, and Taxation

The measure would not change local taxes and fees on gambling. The measure would establish a variety of state licensing and application fees, fines for violations of state law, and a gross revenue tax on the slot machines in the City of Palm Springs. Card room annual licensing fees would be determined by the commission and the total revenue generated by the fees would be limited to the cost of the regulation.

The measure would establish a state tax of 10 percent of an annual gross revenue tax on the City of Palm Springs' slot machines. These funds must be distributed on a statewide basis for support of local public safety functions (in the same fashion as Proposition 172 funds are currently allocated).

STATE AND LOCAL FISCAL EFFECTS

State Fiscal Effects

Impact on State Revenues. The measure could result in additional General Fund and special fund revenues of up to tens of millions of dollars annually from income and sales taxes. The amount would depend upon the number of localities that approve or

expand gaming and the increase in economic activity associated with the measure (including the degree to which Californians and tourists shift their gaming activities from other states to California and gambling increases on Indian reservations).

These increased revenues would be partially offset to the extent that increased casino-style gaming activities replace other forms of gaming currently available in California, such as the lottery and horse racing. Also, revenues generated from gaming on reservations would be less than that for other comparable operations situated on non-Indian land because Indian tribes are exempt from certain taxes.

Regulatory and Administrative Costs. Approximately $10 million would be required annually to cover the state's regulatory and administrative costs associated with the measure. The majority of these costs would be for the activities of the Gaming Control Commission and the Department of Justice's Division of Gambling Control. These costs would be offset completely by fees and fine revenue paid by licensees.

Local Fiscal Effects

Local Revenues. The measure could potentially result in up to tens of millions of dollars in additional gross revenue and business taxes to local jurisdictions. First, the 10 percent gross revenue tax on the Palm Springs' slot machines alone could return an amount in the low tens of millions of dollars for added support of local public safety functions.

Second, local governments would receive increased revenues from taxes relating to secondary economic activity in their areas associated with gaming operations. The level of increase is unknown, but potentially in the tens of millions of dollars annually. These projected revenue increases are statewide totals. The fiscal impacts on individual localities could vary significantly.

Local Enforcement Costs. Depending on the level of gambling activity, the measure could result in unknown local costs related to possible increased law enforcement.

SUMMARY OF FISCAL EFFECTS

This measure would have the following major fiscal effects:

- Net state revenues could increase by up to tens of millions of dollars annually from taxes associated with gambling operations and other related economic activity.

- Local revenues could increase up to tens of millions of dollars annually from additional taxes and fees from gaming operations and other related economic activity. Some of these revenues would be restricted to use for local public safety activities.

Sincerely,

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Elizabeth G. Hill
Legislative Analyst

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Craig L. Brown
Director of Finance