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Authorization of Online Poker in California

LEGISLATIVE ANALYST'S OFFICE

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Hon. Roderick Wright, Chair

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Federal Law Allows States to Authorize Intrastate Online Gambling

- Under the Federal Unlawful Internet Gambling Enforcement Act (UIGEA) of 2006, it is generally unlawful now 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 non-state residents from participating in online gambling.

- At this time, there are bills pending in Congress to legalize online gambling across all states, which would likely impact the revenues that states could generate from intrastate, online gambling.

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How Much Revenue Could Actually Be Generated in California?

☑ Our analysis indicates that the actual level of state revenue that could be generated from authorizing online poker in California would depend heavily on a variety of factors. These factors include:

- Possible legal issues regarding tribal-state compacts.
- How legal poker Web sites would be implemented in California.
- The number of people that would play online poker, as well as the amount wagered, on legal Web sites.
- The extent to which the legal Web sites are able to capture monies that are currently being wagered on illegal Web sites.

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Possible Legal Issues Regarding Tribal-State Compacts

- The existing tribal-state compacts that have been ratified by the Legislature require the tribes to make payments to various state accounts. For example, the compacts ratified in 2003 and after require tribes to make annual payments to the state, which are deposited into the General Fund. (The Governor's budget for 2010-11 assumes that the General Fund will receive $365 million in revenue from these tribes in the budget year.)

- These compacts also contain provisions limiting the state's ability to authorize certain types of gambling that could compete with the tribal casinos. These compacts may allow the tribes to stop making some payments to the General Fund if the state authorizes certain types of competing gambling enterprises.

- There could be legal challenges that legal poker Web sites violate the above provisions in tribal-state compacts if online poker is approved in California. If such challenges were upheld, the state could lose hundreds of millions of dollars in revenue annually. Thus, the Legislature should work closely with the Office of Legislative Counsel and other legal experts to assess these risks if it wishes to consider proposals in this area.

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How Legal Poker Web Sites Would Be Implemented

- ***State Share of "Gross Revenues."*** One of the primary factors in how much revenue the state would generate is what portion of gross revenues it would receive from the legal Web site operators. Given the state's fiscal difficulties, one goal could be maximizing 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 Web sites (such as for marketing and incentives to retain players).

- ***State Regulations.*** The state would incur regulatory costs to prevent unauthorized users from playing on legal poker Web sites. In addition, it is not clear what specific steps individuals in California would need to take to be able to play on legal poker Web sites (such as providing proof of residency and paying registration fees). If these requirements were extensive, however, they could be a barrier to player participation.

- ***Number of Web Sites.*** Although the existence of multiple legal poker Web sites within California could promote competition, having too many sites could result in each site not having sufficient players to facilitate poker games, as sometimes occurs on illegal Web sites.

- ***Tax Revenue.*** The Web site could be designed to make it easier to collect income taxes on net winnings. Currently, players using illegal Web sites have little incentive to report gambling winnings for tax purposes. The state could require that such Web sites report such information to the state. However, this could deter some players from using the legal Web sites. The state would also collect taxes from the operators of legal poker Web sites as well as their employees.

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Various Factors Could Impact Player Participation in Legal Online Poker

- ***Cost to Play.*** If the cost of playing on legal poker Web sites was greater than the cost of playing on illegal Web sites, 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 Web sites, the legal Web sites would be able to provide players with a greater sense of security and comfort in that they would know that they are not engaging in an illegal activity.

- ***Incentives to Retain Players.*** Many of the existing illegal Web sites offer financial incentives to retain players. For example, some sites offer bonuses to players that they can collect only after playing a predetermined amount of time. This could make it more difficult for new California online Web sites to capture a share of the market in the near term. The state could allow similar incentives for its games.

- ***Games Offered.*** Legal poker Web sites would have to compete with existing illegal Web sites that have little or no limits on the types of games offered.

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Two Potential Sources of State Gaming Revenues From Online Poker

☑ State Revenues From Redirecting Wagering From Illegal Web Sites

- Several studies estimate that illegal Web sites 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 Web sites, these potential gambling activities could generate new revenues for the state.

☑ State Revenues From 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.