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Taxing Intrastate Tribal Poker in California

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Would state put a tax on tribes' online poker?

By Malcolm Maclachlan | 01/13/11

With online poker refusing to leave the legislative stage in Sacramento, and with many of California's biggest gaming tribes pushing hard for a seat at the table, one question looms: Will the state tax the money that tribes and their members make off of online poker?

It's a question up to the Legislature and governor, if they decide to finally go ahead with online poker franchises for California citizens.

"It would depend on how the bill is written," said Allison Harvey, director of governmental affairs for the United Auburn Indian Community, one of the California's largest casino gaming tribes. "Since it's not a part of federal law, they would have to do it through state law."

It's not a question that will likely make a huge difference in the state's looming budget deficit. But for individual tribal members, it could mean a big difference in income. For many tribal members, casino incomes aren't subject to taxation by the state — but only if the person is a tribal member living on their own tribe's reservation and the casino is also located there.

This distinction saves significant money for many of the estimated 3,500 tribal members receiving "per capita" payments from casino compacts. Since many of these people receive upwards of \$20,000 a month, a significant portion of their income could be hit by California's 9.5 percent top marginal tax rate.

But these rules are specifically written into the state's gaming compacts with tribes. The federal Internal Revenue Service taxes casino per capita payments just like any other income.

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If the tax rules are modeled on the corresponding rules for taxing tribes' casino profits, it would affect the way Internet poker is set up by the tribes.

One key question is where the law decides the money is being made.

When a person visits a casino on an Indian reservation, and the money they lose is paid out to a member of that tribe living on that reservation, the rules are clear.

But when that game takes place on the Internet, a question arises: Is the game considered to be located where the customer is sitting at their computer or where the Internet server is located?

Gaming attorney Sanford Millar said legal precedents suggest it would be where the server is located. But he added that putting server farms on remote reservations may not be practical, especially if two dozen or more tribes are involved.

“No one is going to get them on the reservation,” Millar said. “They’re going to be housed at Cisco or Google or someplace with a server farm. It’s not like you just plug in a phone line.”

However, Millar said that he could envision some kind of a deal that would shield tribal members from taxes. That, in turn, could lead to a major migration of tribal members moving back on to reservations in order to take advantage of the tax breaks – if the rules were the same as those for taxing casino payments.

Another attorney who has worked with tribes, I. Nelson Rose, countered that there is an example of tribes hosting Internet servers: the Kahnawake Mohawks in Quebec. The tribe established the Kahnawake Gaming Commission in 1996. A decade later, they bought a pair of poker technology companies, Absolute Poker and Ultimate Bet. This and other investments left the tribe with a significant stake in the worldwide online poker market – worth an estimated \$18 billion in 2008, according to a story in the Washington Post.

Rose noted that non-tribal online gaming operators have located in similarly hard to reach places — such as Gibraltar or the Isle of Man. He noted that Ruth Parasol, the San Francisco native who cofounded PartyGaming.com and briefly made it onto the Forbes 400 list of the richest Americans, moved to Gibraltar fulltime in 2004.

What is most likely is that the tribes would work out some deal to pay a share of revenue to the state, Rose said, while also making sure that payments to tribal members were not taxed by the state. And barring that, tribes also have plenty of ways to benefit their members without paying money directly into their pockets, which could be another way to help shield this money from the state Franchise Tax Board.

“They could buy everybody a house and they wouldn’t tax that,” Rose said.

Then there’s the matter of the Rincon decision, which could affect how the state negotiates with tribes over both casino gaming compacts and online gaming.

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Last April, three federal appeals judges on the U.S. 9th Circuit ruled then-Gov. Arnold Schwarzenegger had negotiated in bad faith with the Rincon Band of Luiseno Mission Indians over a revised casino gaming compact in 2003. By demanding what the court described as an unreasonable one quarter of the revenue from the tribes' slot machines, the state has crossed the line by imposing a federally-barred "state tax" on the tribe.

To further complicate matters, any poker bill might run up against Proposition 26. This ballot initiative passed in November imposes a two-thirds vote for fees imposed by state and local governments, just like the supermajority the legislature has long needed in order to pass taxes. In other words, an online poker bill that makes money for the state would need a couple Republican votes in each house. Many Republican legislators have historically been hostile to expanding gaming on moral grounds.

The major online poker effort in California has been led by the Morongo Band of Mission Indians, who began trying to put together a Tribal Consortium to offer online poker in 2009. That effort has been unsuccessful so far, held up by questions about whether their plan would violate the "exclusivity clause" written into tribal gaming compacts and the fact that the consortium would have had a virtual monopoly, with non-tribal interests excluded.

But the tribe was successful in bringing together their consortium, now known as the California Online Poker Association (COPA). The association includes 21 tribes and a number of card rooms.

There are currently two bills in print that would legalize Internet poker in California: SB 40 by Sen. Lou Correa, D-Santa Ana, and SB 45 by Sen. Rod Wright, D-Los Angeles.

Neither bill has language that would definitely settle the tax issue, though Correa's SB 40 appears to lean against taxing this revenue for tribes. COPA has thrown their support behind Correa's bill. So has the California Gaming Association (CGA), which represents the majority of the state's licensed card rooms.

The California Tribal Business Alliance, a group of four major gaming tribes, opposes Correa's bill – in part because it does not appear to sufficiently shield tribes from taxes.

According to their Dec. 17 opposition letter to Correa: "Under this bill the 'legal entity' authorized to offer Internet poker would be subject to a state tax based on a 'percent of the fees collected by the licensed entity from players participating in poker games conducted on its Internet website.' By requiring tribes to offer Internet gaming only through such an entity, tribal governments would be required to consent to a state tax as a condition of participating in Internet poker. This proposal is highly objectionable, as it is contrary to federal policy that Indian Tribal governments are not taxable entities. Consistent with federal law and policy, tribes should be permitted to offer Internet poker from their Indians lands free of state taxation and regulation."

However, the way this is written allows a great deal of variability, and would appear to set an agreed – upon fee on the gaming revenue itself – not on the actual profits tribes and their members take out after the fact.

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Meanwhile, a member of Sen. Wright's staff said that he was inviting all the interested parties to meet regularly as part of a "working group" that could hammer out issues such as taxation, tribal sovereignty as it applies to the games, and even what types of games may be offered. Wright has also submitted a request to the legislative counsel, seeking to determine if a poker bill with revenue for the state would require a two-thirds votes.

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