

## CHARITABLE GAMING ORGANIZATION ELIGIBILITY REQUIREMENTS - BACKGROUND MEMORANDUM

Section 5 of 2011 Senate Bill No. 2042 (attached as an [appendix](#)) directs the Legislative Management to study the eligibility requirements for the veterans', charitable, educational, religious, fraternal, civic and service, public safety, and public-spirited organizations that conduct charitable gaming.

In addition to a discussion of eligibility requirements for organizations that conduct charitable gaming, this memorandum describes the history of charitable gaming laws in North Dakota, from the beginning of statehood through the inception of charitable gaming in 1977, and changes to the charitable gaming laws in the 34 years since 1977.

### CHARITABLE GAMING

#### Early History

In the first legislative session after statehood (1889-90), an attempt was made to establish the Louisiana lottery, which was seeking a new home in light of the impending revocation of its charter in its state of origin. The operators of the lottery were willing to offer the state an initial payment of \$100,000, followed by annual payments of \$75,000, for the privilege of operating a lottery. The scandal and controversy following this attempt led to the state's first constitutional amendment. The amendment added what eventually became Article XI, Section 25, of the Constitution of North Dakota and outlawed all forms of lotteries and gift enterprises.

The constitutional prohibition was maintained until 1976, when it was amended to allow certain forms of charitable gaming. Under the provision, the Legislative Assembly is permitted to authorize bona fide nonprofit veterans', charitable, educational, religious, or fraternal organizations, civic and service clubs, or such other public-spirited organizations as it may recognize, to conduct games of chance when the entire net proceeds of the games are devoted to educational, patriotic, fraternal, religious, or other public-spirited use.

Before 1976 attempts had been made to allow other forms of gaming in the state. In 1943 a bill was defeated which would have allowed pari-mutuel horse racing by county fairs and similar organizations. In 1968 the voters rejected an initiated measure that would have amended the constitution to permit pari-mutuel betting. The 1972 Constitutional Convention proposed a new constitution that would have omitted the provision prohibiting lotteries. At the election on the proposed constitution, adoption of an alternative prohibiting lotteries and gift enterprises was disapproved, i.e., had the basic revised constitution passed, gaming would implicitly have been permitted.

#### Advent of Charitable Gaming

After passage of the constitutional amendment in 1976, a temporary law was passed by the 1977 Legislative Assembly followed by another temporary law in 1979, and finally legislation in 1981 which was codified as North Dakota Century Code Chapter 53-06.1. All three laws became effective without the approval of the Governor holding office at the time of passage. A bill passed by the Legislative Assembly in 1987 added Chapter 53-06.2, allowing charitable organizations to conduct pari-mutuel horse racing.

Many changes have been made to the charitable gaming law during the 18 legislative sessions since passage of the constitutional amendment. During the first three interims after passage of the law in 1981, Legislative Council interim committees studied charitable gaming and suggested many of the changes that have since been made to the law. The most comprehensive proposal was that of the 1981-82 interim Political Subdivisions Committee. That committee suggested a bill that, when enacted, contained 23 sections changing various aspects of the charitable gaming law. Changes from that session and others have primarily affected the kinds of games that can be held, the kinds of organizations that can hold them, the allocation of expenses of conducting the games, administration of the charitable gaming law, enforcement of the charitable gaming law, and taxation of gaming proceeds.

#### Charitable Organizations

There are two critical elements specifically mentioned in the constitutional amendment allowing charitable gaming--the kinds of organizations that can conduct the games and the use that is made of the proceeds from the games. The constitutional provision requires that the charity be a "bona fide nonprofit veterans', charitable, educational, religious, or fraternal" organization, or a civic or service club, or a "public-spirited" organization authorized by the Legislative Assembly. The constitutional provision also requires that the net proceeds be used only for "educational, charitable, patriotic, fraternal, religious, or other public-spirited uses."

All organizations must meet the first test in order to conduct charitable gaming. Some of these organizations also meet the second test and thus can use the net proceeds for the organization's own purpose. Other charities meet only the first constitutional test so cannot use the proceeds themselves. Instead they must give the proceeds to beneficiaries who meet the second test.

Under Section 53-06.1-01, "eligible organization" is used to generically describe all the kinds of organizations permitted to conduct games of chance.

Subsection 7 of Section 53-06.1-01 defines "eligible organization" as follows:

7. "Eligible organization" means a veterans, charitable, educational, religious, fraternal, civic and service, public safety, or public-spirited organization domiciled in North Dakota or authorized by the secretary of state as a foreign corporation under chapter 10-33, incorporated as a nonprofit organization, and which has been regularly and actively fulfilling its primary purpose within this state during the two immediately preceding years. However, an educational organization does not need to be incorporated or be in existence for two years. An organization's primary purpose may not involve the conduct of games. The organization may be issued a license by the attorney general. For purposes of this section, a foreign corporation authorized under chapter 10-33 is not an eligible organization unless authorized to conduct a raffle under chapter 20.1-04 or 20.1-08 and may not conduct a game other than a raffle under chapter 20.1-04 or 20.1-08.

Other statutory definitions are provided to describe the specific kinds of organizations enumerated in the constitution. Particular definitions are provided in Section 53-06.1-01 for charitable, civic and service, educational, fraternal, public safety, public-spirited, religious, and veterans' organizations, respectively. The statutory definitions for each of these terms are as follows:

2. "Charitable organization" means an organization whose primary purpose is for relief of poor, distressed, underprivileged, diseased, elderly, or abused persons, prevention of cruelty to children or animals, or similar condition of public concern.
3. "Civic and service organization" means an organization whose primary purpose is to promote the common good and social welfare of a community as a sertoma, lion, rotary, jaycee, kiwanis, or similar organization.
6. "Educational organization" means a nonprofit public or private elementary or secondary school, two-year or four-year college, or university.
8. "Fraternal organization" means an organization, except a school fraternity, which is a branch, lodge, or chapter of a national or state organization and exists for the common business, brotherhood, or other interests of its members. The organization must have qualified for exemption from federal income tax under section 501(c)(8) or 501(c)(10) of the Internal Revenue Code.

18. "Public safety organization" means an organization whose primary purpose is to provide firefighting, ambulance service, crime prevention, or similar emergency assistance.
19. "Public-spirited organization" means an organization whose primary purpose is for scientific research, amateur sports competition, safety, literary, arts, preservation of cultural heritage, educational activities, educational public service, youth, economic development, tourism, community medical care, community recreation, or similar organization, which does not meet the definition of any other type of eligible organization. However, a nonprofit organization or a group of people recognized as a public-spirited organization by a governing body of a city or county for obtaining a permit does not need to meet this definition.
20. "Religious organization" means a church, body of communicants, or group gathered in common membership whose primary purpose is for advancement of religion, mutual support and edification in piety, worship, and religious observances.
21. "Veterans organization" means any congressionally chartered post organization, or any branch or lodge or chapter of a nonprofit national or state organization whose membership consists of individuals who are or were members of the armed services or forces of the United States. The organization must have qualified for exemption from federal income tax under section 501(c)(19) of the Internal Revenue Code.

In 1991 the legal distinction between Class A and Class B licenseholding gaming organizations was changed. Under previous law, a Class A license could be held only by an organization that maintained a building for use of its members and guests. Under 1991 legislation, a Class A license is issued to an organization that is prohibited because of its nature from expending charitable gaming proceeds for the organization's own purposes or benefits. A Class B license is issued to an organization that is permitted to expend charitable gaming proceeds for its own uses. In 1995 the distinctions between Class A and Class B gaming organizations were eliminated.

### **Games Permitted**

Under the original 1977 law, the only games permitted were bingo, raffles, pull tabs, jars, and punchboards. The 1979 law added sports pools on professional sports. In 1981 charities were first permitted to conduct the game of twenty-one. In 1987 draw poker and stud poker were added to the list of permitted games. Also, that same year

Chapter 53-06.2 was enacted which allows most charities to conduct horse racing under the pari-mutuel system. The pari-mutuel betting system is one in which bets are placed in a pool, a percentage is taken out for the race organizer (the charity) and taxes, and the remainder is divided up among the bettors who selected the horses finishing well enough. The definitions of qualifying organizations are similar to those under Chapter 53-06.1, except that educational organizations are omitted.

There were three additions made to the types of games in 1989. Eligible organizations were permitted to conduct calcuttas, allow off-track pari-mutuel betting on races held at licensed racecourses inside or outside the state, and use electronic video gaming devices in place of normal methods of playing otherwise allowable games of chance. However, legalization of electronic video gaming was referred and rejected at a special election on December 5, 1989. In 1991 paddlewheels were added as a game of chance.

### **Taxation of Charitable Gaming Proceeds**

A state tax has been imposed on the proceeds of charitable gaming since 1977. In the 1977 law, a tax of 3 percent of adjusted gross proceeds was established and allocated to the general fund of the state. The tax was part of the expense limit for the charity. The tax rate was increased to 5 percent in 1979 and was payable from adjusted gross proceeds (and not charged against the allowable expenses of the charity).

Before July 1, 2011, the gaming tax structure, which is contained in Section 53-06.1-12, provided for a sliding scale tax rate that was based upon an organization's adjusted gross proceeds. The tax structure also provided that in addition to any other tax, an excise tax of 3 percent was imposed on the gross proceeds from the sale at retail of pull tabs and 3 percent on the gross proceeds from the sale at retail of bingo cards to final users. For those organizations that did not have gross proceeds of pull tabs that exceed \$4,000 per calendar quarter, no excise tax was imposed. Under this section, the Attorney General was required to deposit 3 percent of the total taxes collected under this section into a gaming and excise tax allocation fund. The money in this fund, pursuant to legislative appropriations, is to be distributed quarterly to cities and counties in proportion to the taxes collected under this section from licensed organizations within each city or county.

A significant change in the gaming tax structure was passed by the Legislative Assembly in 2011. This legislation consolidated all gaming taxes into single tax rates. The bill provides that gaming tax rates, which range from 1 percent to 2.5 percent, are based upon an organization's quarterly gross proceeds. The legislation that led to this change--Senate Bill No. 2042--is discussed later in this memorandum.

### **Administration of the Charitable Gaming Law Licensing Procedures**

From the inception of charitable gaming, administration of the law has been the responsibility of the Attorney General and local officials. The phrase "licensing authority" has been used in each version of the law to refer to the Attorney General. The Attorney General has served as the primary licensing authority since 1977, and local jurisdictions have had varying roles over the years.

Under both the 1977 and 1979 laws, charities maintaining their own buildings for use by members and also serving meals and liquor were licensed by the Attorney General, while other charities were required to secure approval from local officials to operate their games.

The licensing procedure was rearranged and a two-tiered license system was established in 1981. Class A licenses were issued to charities that maintained a building for their own use and which served meals or liquor. All other charities were granted Class B licenses. Under a 1995 law, the tiered licensing system was eliminated. Effective July 1, 1995, the same licensing classification applied to all organizations. The annual license fee was standardized at \$150 for all organizations. Previously, the license fee for an organization whose annual gross proceeds did not exceed \$25,000 was \$100. Other organizations paid \$150.

### **Role of Local Officials**

Local government officials have had a role in charitable gaming since the first law. Local government officials were the primary approving agency for what were known as Class B charities. Since 1979 local government officials have been the primary approving agency for the issuance of a local permit or a charity local permit for conducting raffles, bingo, sports pools, paddlewheels, twenty-one, and poker. Although the Attorney General now licenses charities, local officials are still involved in charitable gaming.

### **Enforcement of the Charitable Gaming Laws**

Since the 1977 law, responsibility for enforcement of the charitable gaming law has been shared by the Attorney General and local officials. In 1991 the Legislative Assembly passed legislation that provided for the State Gaming Commission to have an increased role in charitable gaming enforcement. Enforcement attention has been directed both at preventing crimes and at ensuring compliance with the many requirements of the law.

Primary difficulties encountered in preventing crimes are the volume of activity and subtlety of some of the cheating methods. Likewise the subtlety of cheating has caused enforcement difficulties. The State Gaming Commission has adopted extensive rules governing accounting procedures and auditing methods to increase opportunities to prevent and detect cheating by players or gaming personnel.

In 1991 the State Gaming Commission was created consisting of a chairman and four other members appointed by the Governor with the consent of the Senate. The bill provided that the State Gaming Commission would share authority with the Attorney General to impose fines on organizations, distributors, and manufacturers who violate any provisions of law or rule and to suspend or revoke a charitable gaming distributor's or manufacturer's license for violation of any provision of law or rule. In 1993, however, the sole authority to impose fines and to suspend or revoke licenses was returned to the Attorney General. The commission is given full authority for adoption of rules to implement the charitable gaming laws.

The 2011-13 budget for the Gaming Division of the Attorney General's office includes a full-time equivalent staff of 15 people. Total budgeted salaries and wages amount to \$2,059,804. The total funding to the Gaming Division is \$2,818,486 for the 2011-13 biennium. This amount includes \$510,000 in local gaming enforcement grants. The total funding to the Gaming Division includes \$261,128 for Indian Gaming and \$7,368 for the State Gaming Commission.

### **2009-10 Interim Judiciary Committee and 2011 Charitable Gaming Legislation**

The 2009-10 interim Judiciary Committee was assigned the responsibility for studying charitable gaming and pari-mutuel racing laws to determine whether the laws regarding taxation, limitations, administration, enforcement, conduct, and play of charitable gaming are fair, adequate, and appropriate. The committee reviewed extensive information submitted by the Gaming Division of the Attorney General's office and charitable gaming organizations with regard to all aspects of the charitable gaming industry. According to the testimony, although the charitable gaming industry in North Dakota continues to be fairly healthy, there has been a decrease in the number of licensed gaming organizations over the years. It was noted that without periodic changes to the play of games, gaming activity tends to go flat. It was also noted that expenses continue to rise for the charities, especially with the increases in the minimum wage. The committee received testimony that suggested that it may be time to review the laws relating to the gaming tax structure and the allowable expense structure. In response to this testimony, the committee recommended a bill that provided for the consolidation of the allowable expense limit from a graduated rate to a flat rate of 60 percent for all organizations and consolidates all gaming taxes into a flat rate of 1 percent of gross proceeds rather than a graduated tax on adjusted gross proceeds. The bill also increased from 3 percent to 10 percent the amount of the total taxes collected which is deposited into the gaming tax allocation fund. Senate Bill No. 2042, as passed, provides for the consolidation of the allowable expense limit from a graduated rate to a flat rate of 60 percent for all licensed gaming

organizations. The bill consolidates all gaming taxes into single tax rates. The bill provides that gaming tax rates, which range from 1 percent to 2.5 percent, are based upon an organization's quarterly gross proceeds. The bill also provides that the Attorney General is required to deposit 6 percent of the total taxes collected into a gaming and excise tax allocation fund to be distributed quarterly to cities and counties in proportion to the taxes collected from licensed organizations conducting gaming within those cities and counties. The new tax structure, which became effective July 1, 2011, is contained in subsection 1 of Section 53-06.1-12. The new tax structure is as follows:

1. A gaming tax is imposed on the total gross proceeds received by a licensed organization in a quarter and it must be computed and paid to the attorney general on a quarterly basis on the tax return. This tax must be paid from adjusted gross proceeds and is not part of the allowable expenses. The tax rate for a licensed organization with gross proceeds:
  - a. Not exceeding five hundred thousand dollars is one percent of gross proceeds.
  - b. Exceeding five hundred thousand dollars but not exceeding one million dollars is one and one-half percent of gross proceeds.
  - c. Exceeding one million dollars but not exceeding one million five hundred thousand dollars is two percent of gross proceeds.
  - d. Exceeding one million five hundred thousand dollars is two and one-half percent of gross proceeds.

Senate Bill No. 2042, as passed, also called for this study of the eligibility requirements for the veterans', charitable, educational, religious, fraternal, civic and service, public safety, and public-spirited organizations that conduct charitable gaming.

The 2011 Legislative Assembly also enacted House Bill No. 1380, which related the definition of "eligible organization." This bill added a reference to raffles conducted under Chapter 20.1-04.

### **SUGGESTED STUDY APPROACH**

The committee, in its study of the eligibility requirements for the veterans', charitable, educational, religious, fraternal, civic and service, public safety, and public-spirited organizations that conduct charitable gaming, may wish to approach this study as follows:

- Request the Attorney General to present information on the eligibility requirements for the organizations that conduct charitable gaming, including information regarding the

licensed organizations that are included within each category;

- Request information and recommendations from representatives of the charitable gaming industry and the public regarding areas of concern with the eligibility requirements for charitable gaming organizations; and
- Develop recommendations and prepare legislation necessary to implement the recommendations.

ATTACH:1