Prepared by the North Dakota Legislative Council staff for the Judiciary Committee
September 2009

CHARITABLE GAMING AND RACING ADMINISTRATION - BACKGROUND MEMORANDUM

Senate Concurrent Resolution No. 4028 (attached as an appendix) directs the Legislative Management to study charitable gaming and pari-mutuel racing laws to determine whether the laws regarding taxation, enforcement, limitations, administration, conduct, and play of charitable gaming are adequate and appropriate.

Under North Dakota Century Code Chapters 53-06.1 (Games of Chance) and 53-06.2 (Pari-Mutuel Horse Racing), certain charitable organizations are permitted to conduct a limited array of games of chance. This memorandum describes the history of charitable gaming and pari-mutuel racing laws in North Dakota from the beginning of statehood through the inception of charitable gaming in 1977 and changes to the charitable gaming and pari-mutuel racing laws in the 32 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 the prohibition 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 Legislative Assembly in 1977, followed by another temporary law in 1979, and finally legislation in 1981 which was codified as 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 17 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 and 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. 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 civic and service, educational, fraternal, public-spirited, religious, and veterans' organizations, respectively.

In 1991 the legal distinction between Class A and Class B licenseholding gaming organizations was changed. Under previous law, a Class A license could only be held 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.

Proceeds

An understanding of some terms commonly used in discussing charitable gaming activity may be useful. Most of these are defined by statute. Section 53-06.1-01 defines gross proceeds as "all cash and checks received from conducting games." For most games, this figure also represents the total risked by the bettors. However, in the game of twenty-one, bettors are paid in chips while at the table and may bet the same chip two or three times before finally losing it or cashing it in. Thus, for twenty-one, gross proceeds is the amount the charity "won."

Another important term is adjusted gross proceeds. This is defined by Section 53-06.1-01 as the "gross proceeds less cash prizes, cost of merchandise prizes, bingo cards excise tax, pull tab excise tax, and federal excise tax imposed under section 4401 of the Internal Revenue Code [26 U.S.C. 4401]." Adjusted gross proceeds is an important figure as it is used in determining tax rate and expense limits.

Another important term is net proceeds. Under Section 53-06.1-01, net proceeds are "adjusted gross proceeds less allowable expenses and gaming tax." This is the amount that is used by the charity for qualified charitable purposes.

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.

Conduct of Games

Under the first law the only people permitted to conduct the games were members of the charitable organization. This restriction was retained in the 1979 version. In 1981 the restriction was removed by allowing employees of the eligible organization to operate the games. The Gaming Commission has adopted detailed rules governing the conduct of most games allowed under the law.

In 1991 employees of licensed alcoholic beverage establishments were allowed to provide limited assistance to Class B organizations; however, the organization in question could not have adjusted gross proceeds exceeding $60,000 per quarterly reporting period. In 1995 any organization, regardless of size, was permitted to have an employee of the alcoholic beverage establishment provide gaming assistance on behalf of the organization. In 1997 the persons permitted to conduct games was expanded to include employees of a temporary employment agency who provides services to a licensed organization.

Participation in Games

Another important issue in the context of charitable gaming is who is permitted to participate in the games--whether it is the general public or some smaller group. The first law limited participation in games to members, their spouses, and bona fide guests. As in the case of conducting the games, this restriction was retained in the 1979 law. It was not until the 1981 law that the general public was permitted to play the games and then only those run by Class B charities. Participation in games run by Class A charities was still restricted to members only. With the elimination of the distinction between Class A and Class B organizations in 1995, participation in games is open to the general public. In 1997 legislation was passed that permits the Attorney General to prohibit a person from playing games if the person violates a gaming law or rule.

Since 1983 participation in pull tabs, jars, punchboards, twenty-one, and sports pools has been

limited to people at least 21 years old. Further, those games cannot be conducted when establishments serving alcoholic beverages are required to be closed. These restrictions apply even if the game site is not such a place.

Expense Limits

Allowable expenses are deducted from adjusted gross proceeds to get net proceeds. Allowable expenses are important to the charities because expenditures in excess of the allowable limits must be made up from other contributions the charity receives. It is important to recipients of net proceeds, as a higher expense limit means there will be less net proceeds available for distribution.

Section 53-06.1-11 provides that the allowable expense limit is 51 percent of the first $250,000 of adjusted gross proceeds per quarter and 45 percent of the adjusted gross proceeds in excess of $200,000 per quarter. The section also provides that in addition an organization may deduct as an allowable expense 2.5 percent of the gross proceeds of pull tabs; capital expenditures for security or video surveillance equipment used for controlling games; and if an organization's total actual expenses exceed the allowable expenses, the organization may also deduct the expenses up to two additional percent of the first $200,000 of adjusted gross proceeds per quarter.

Section 53-06.1-11 also establishes rent limits. This section provides that at a site at which bingo is the primary game, the monthly rent must be reasonable; however, if bingo is not the primary game but is conducted with twenty-one, paddlewheels, or pull tabs, no additional rent is allowed. If bingo is conducted through a dispensing device and no other game is conducted, the monthly rent may not exceed $275. This section also sets the rent limits sites at which bingo is not the primary game and at which twenty-one, paddlewheels, or pull tabs are conducted. These rent limits are based upon the number of tables, the amounts of wagers, and whether pull tabs are sold at that particular site.

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.

Regulation of Gaming Equipment

Although most of the statutes and administrative rules deal with conducting or participating in games of chance, there is some regulation of the manufacturers and distributors of equipment particularly designed for games of chance.

Since the first law in 1977, distributors of gaming equipment have been required to obtain a license from the Attorney General, charities have been restricted to buying gaming equipment from licensed distributors, and distributors have also been prohibited from holding alcoholic beverage licenses. Likewise, manufacturers of gaming equipment have been required to obtain licenses from the Attorney General on essentially the same conditions as distributors.

In 1997 the annual license fee for a manufacturer of pull tabs, paper bingo cards, or pull tab dispensing devices was increased from $2,000 to $4,000. The annual licensing fee for a manufacturer of pull tab dispensing devises is $1,000 and the annual licensing fee for a distributor is $1,500.

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 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

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 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 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 2009-11 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 $1,916,174. The total funding to the Gaming Division is $2,670,902 for the 2009-11 biennium. This amount includes $510,000 in local gaming enforcement grants. The total funding to the Gaming Division includes $247,061 for Indian gaming and $6,141 for the Gaming Commission.

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).

Local jurisdictions were first given a share of the tax revenue in 1983. The share amounted to 2 percent of adjusted gross proceeds, payable to the city in which the site was located or to the county for sites outside city limits. Use by local jurisdictions was limited to enforcing the charitable gaming law. That year also saw the advent of the graduated tax. After the first $600,000 of adjusted gross proceeds, the tax increased to 20 percent of adjusted gross proceeds. The purpose of the higher tax was to discourage large-scale charitable gaming.

The current tax structure, which is contained in Section 53-06.1-12, provides as follows:

- On adjusted gross proceeds not exceeding $200,000, a tax of 5 percent;
- On adjusted gross proceeds exceeding $200,000 but not exceeding $400,000, a tax of 10 percent;
- On adjusted gross proceeds exceeding $400,000 but not exceeding $600,000, a tax of 15 percent; and
- On adjusted gross proceeds exceeding $600,000, a tax of 20 percent.

This section further provides that in addition to any other tax, an excise tax of 3 percent is 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 do not have gross proceeds of pull tabs that exceed $4,000 per calendar quarter, no excise tax is imposed. Under this section, the Attorney General is 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.

RACING ADMINISTRATION

Background

In 1987 the Racing Commission was established and pari-mutuel horse racing authorized by the Legislative Assembly. Initially, the Racing Commission was established in the Secretary of State's office. Members of the commission originally were the Secretary of State and four other members appointed by the Governor. In 1989 the Legislative Assembly moved the Racing Commission from the Secretary of State's office to the Attorney General's office. The Secretary of State was removed as chairman of the commission and one other member appointed by the Governor was added. The bill also established the breeders' fund and purse fund. The bill also authorized off-track wagering on races held at licensed racecourses either in state or out of state. In 1991 the Legislative Assembly replaced the off-track wagering statute enacted in 1989 with a similar statute providing for simulcast wagering for in-state or out-of-state races. The bill also created the promotion fund and provided that unclaimed tickets and breakage from each live race and simulcast program be deposited in the promotion fund. The bill also provided that the money in the breeders' fund, purse fund, and promotion fund may be spent by the commission pursuant to a continuing appropriation.

In 1991 the Legislative Assembly also provided that of the Governor's five appointees, one must be nominated by the state chapter or affiliate of the American Quarter Horse Racing Association, one by the state chapter or affiliate of the United States Trotting Association, one nominated by the state chapter or affiliate of the International Arabian Horse Association, and one nominated by the state chapter or affiliate of the North Dakota Thoroughbred Association.

In 1993 the Legislative Assembly authorized simulcast dog racing in the state.

In 2001 the Legislative Assembly authorized pari-mutuel wagering to be conducted through account wagering and that an account wager may be made on an account only through a licensed simulcast service provider authorized to operate the simulcast pari-mutuel wagering system under the certificate system.

In 2003 the Legislative Assembly required the Racing Commission to reinstate race dates and issue a license under the certificate system to any racetrack in the state which was operational after December 31, 2000.

In 2005 the Legislative Assembly passed two bills relating to the Racing Commission. The first, House Bill No. 1003, provided that a member of the Racing Commission who is appointed to fill a vacancy arising from other than the natural expiration of a term who serves the unexpired portion of the term may be reappointed. The second, Senate Bill No. 2340, removed the Racing Commission from the Attorney General's office. The bill authorized the Attorney General to request payment for any services the Attorney General renders to the Racing Commission.

2007-08 Interim Judiciary Committee

During the course of the 2007-08 interim Judiciary Committee's discussion of the formation of a North Dakota gaming commission to regulate and control all forms of gaming in North Dakota, the committee received testimony that expressed concerns about the authority and activities of the Racing Commission as well as the lack of oversight of the commission. Concerns were expressed that the Racing Commission does not work well as a stand-alone agency due in part to the commission's lack of accountability. The committee recommended a bill draft that would have given the Attorney General supervisory authority over the Racing Commission. The bill--2009 Senate Bill No. 2043--failed to pass the Senate.

2009 GAMING-RELATED LEGISLATION

Charitable Gaming

House Bill No. 1194 provided that the maximum allowable value of a primary raffle prize for a raffle conducted with a local permit does not apply to raffles conducted under Chapter 20.1-08. The bill also provided that an eligible organization includes an organization authorized by the Secretary of State as a foreign corporation under Chapter 10-33. The bill provided that the foreign corporation, for purposes of charitable gaming, may not conduct a game other than a raffle under Chapter 20.1-08.

House Bill No. 1317 decreased from 4.5 percent to 3 percent the excise tax on the gross proceeds from the sale at retail of pull tabs.

House Bill No. 1367 increased the maximum allowable value of a primary raffle prize for a raffle conducted with a local permit from $2,500 to $6,000.

Senate Bill No. 2091 provided that the Attorney General rather than the State Treasurer is responsible for depositing gaming and excise taxes in the state treasury.

Senate Bill No. 2215 defined net income as gross proceeds less cash prizes, cost of merchandise prizes, and expenses to conduct the gaming activity. The bill also clarified that various interest, penalties, and taxes apply to licensed organizations.

Horse Racing

House Bill No. 1551 reduced the amount of gaming taxes the horse racing licensee is required to pay the state. The bill also provided that of the amount due for all unclaimed tickets and breakage, 20 percent is to be deposited into the racing promotion fund, 30 percent is to be deposited into the breeders' fund, and 50 percent is to be deposited into the purse fund.

Senate Bill No. 2024, which was vetoed by the Governor, related to the powers and duties of the Racing Commission. The bill would have provided that the commission is established in the office of the Agriculture Commissioner. The bill would have changed the authority for the appointment of the commission members from the Governor to the Agriculture Commissioner. The bill would have provided that the commission is responsible for the aspects of the horse racing industry which deal with live racing. The bill would have transferred from the commission to the Attorney General the authority for the regulation and enforcement of pari-mutuel wagering. The bill also would have lowered the gaming taxes the licensee is required to pay the state. All provisions of the bill other than the changes to the tax structure would have become effective on July 1, 2011.

SUGGESTED STUDY APPROACH

The committee, in its study of charitable gaming and pari-mutuel racing laws to determine whether the laws regarding taxation, enforcement, limitations, administration, conduct, and play of charitable gaming are adequate and appropriate, may wish to approach this study as follows:

- Request the Attorney General to present information on areas of concern in the gaming industry, including types of enforcement actions, investigations and prosecutions, concerns regarding the conduct and play of the games, concerns regarding taxation and expense limits, and trends in the charitable gaming industry;
- Request information and recommendations from representatives of the charitable gaming industry and the public regarding areas of concern in the charitable gaming laws and rules;
- Request information and recommendations from the Racing Commission, the Attorney General, the Agriculture Commissioner, and representatives of the racing industry regarding the administration of racing in the state; and
- Develop recommendations and prepare legislation necessary to implement the recommendations.

ATTACH:1