



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Lee Wilcox  
Edgardo Garcia

**SUBJECT: POTENTIAL CARDROOM  
REVENUE MEASURE**

**DATE:** June 14, 2018

Approved

*D. D. S. Y. L.*

Date

*6/14/18*

## RECOMMENDATION

- (a) Discussion of a potential Cardroom Business Tax Revenue Ballot Measure.
- (b) Direct the City Manager to analyze and develop recommendations for extending the 15 percent Cardroom Business Tax to the Third-Party Proposition Player Services Businesses, engage with the City's two cardrooms on possible alternative approaches, and return to the Council on August 7, 2018 with a recommended ballot measure.

## OUTCOME

If the Council approves this item, the Administration will continue discussions with the City's two cardrooms regarding potential changes to the Cardroom Business Tax. The Administration will bring a recommendation to Council on August 7, 2018 regarding whether to place a ballot measure on the November 2018 ballot.

## BACKGROUND

The City's financial position remains fragile with limited ability to increase priority services to acceptable levels or to levels that meet resident demand. Pursuing additional revenue sources to address San José's structural deficit and underlying fiscal challenges was an important part of the General Fund Structural Deficit Elimination Plan (2008) and the Fiscal Reform Plan (2011). These Council-approved plans envisioned securing new revenue after the City completed significant cost-cutting measures during the Great Recession, including deep cuts in city services.

In 2016, City voters approved Measure B, a one-quarter cent sales tax increase for fifteen years, and Measure G, a modernization of the City's Business Tax. These actions estimated increasing annual revenue by \$52 million. While service levels and staffing level in the San José Police Department have improved, service levels continue to be lower than what our residents expect or

deserve. In addition, there are significant deferred infrastructure needs that, if unfunded, will continue to grow more costly to address in the future.

Both of the 2016 revenue measures were first considered in 2011 as a part of the City's Fiscal Reform Plan, stemming from the 2008 City Manager's General Fund Structural Deficit Task Force's (Task Force) Report. This report, the "General Fund Structural Deficit Elimination Plan." offered other potential revenues for the City Council to consider related to the City's two cardrooms. These recommendations included:

- Increasing the Cardroom Business Tax rate;
- Increasing the number of tables each cardroom is permitted to have; and
- Extending the Cardroom Business Tax to those businesses providing third-party proposition player services(TPPPS) in the cardrooms.

For background, Title 16 of the San Jose Municipal Code was enacted by the City Council on November 9, 1999 and restructured the City's gaming regulations. Title 16 establishes the City's gaming control regulatory program and sets forth the local requirements associated with expanding gaming within the City. Title 16, Section 16.04.030, states that the City Council shall not take any action to expand gaming in San José without voter approval. Up until voters approved Measure K in 2010, Section 16.04.030 defined "Expansion" to include an increase in: cardrooms or cardroom tables; bet limits; total number of games; use of slot machines or devices; and, any form of gambling which is not allowed under Title 16.

Gaming in San José is also regulated under provisions of the State of California Gambling Control Act (the "Act"), Business and Professions Code, Division 8, Chapter 5. There are several so-called moratorium provisions that control the expansion of cardroom gambling under Article 13 of the Act. The Act requires that an increase to the current number of gambling tables in San José requires voter approval. Additionally, under the Act, any proposed amendment to the City's cardroom regulations in Title 16, whether effectuated by a City Council adopted ordinance or a measure approved by the voters, must be submitted to the State's Department of Justice for review and comment before its adoption. The State has no authority to review or comment on the Cardroom Tax.

#### *Increase Cardroom Business Tax and Tables*

Since 2008, the City has moved forward with implementing one of the Task Force's recommendations related to cardroom tax revenues. On June 8, 2010, San José voters approved Measure K<sup>1</sup>, which increased the Cardroom Tax rate from 13 percent to 15 percent of the cardroom's gross revenues, increased the number of cardroom tables by 18 tables, permitted any card game and betting limits authorized under State law. As a result, the number of tables authorized per cardroom increased from 40 to 49. This measure passed with 76 percent approval.

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<sup>1</sup> Text of Measure K: <http://www.sanjoseca.gov/documentcenter/view/649>

Two years later, a cardroom-sponsored initiative was on the ballot. On November 6, 2012, San José voters denied Measure E, which would have increased the number of cardroom tables by 30 in 2013 and another 30 in 2014, and allowed “any form of gaming lawful in California after July 1, 2012.” This measure had the potential to allow cardrooms to add slot machines and other gambling devices, if allowed by State law. This measure failed with 58 percent voting no.

### *Extend Cardroom Business Tax to TPPPS*

A TPPPS is a separate and distinct business entity which is under contract with, and operates in, a licensed cardroom with the specific purpose of acting as a “banker” to the players in the various games offered. State law and the San José Municipal Code do not allow the cardrooms to serve as the “banks.” Since the Task Force made its recommendations, the City has not moved forward with a ballot measure to tax the revenues of the TPPPS.

Staff recommends that the Council direct the City Manager to return to Council on August 7, 2018 with a recommendation on options for capturing additional revenue to support critical city service restoration efforts through changes to the Cardroom Business Tax and the cardroom regulations. While the Administration will focus on the extension of the existing 15 percent Cardroom Business Tax to the TPPPS Business, other elements under consideration for a possible ballot measure include a mix of the following elements:

- Increase the existing 15 percent Cardroom Business Tax;
- Increase the number of tables allowed within the City of San José; and/or
- Amend the San José Municipal Code to create greater flexibility for the City’s two cardrooms to better compete with other regional competition. For example, the City of San Jose currently prohibits “Jackpots” while other cardrooms in the regional do not.

### **ANALYSIS**

This section of the report outlines the policy considerations and elements Council may wish to include in a ballot measure for the November 6, 2018 citywide ballot.

As mentioned above, there are several elements to consider to raise revenues. As a starting point, the 15 percent Cardroom Business Tax (Tax) was approved in 2010 with an increase of 18 tables. The 15 percent is calculated on the gross revenues of the two cardrooms derived from card game business subject to the permit. The cardrooms’ revenues from other aspects of their businesses, such as food and beverage, are not included in the gross revenues for purposes of calculating the Cardroom Tax. The Tax generated \$18.7 million to the City’s General Fund in fiscal 2016-17. A 15 percent tax rate applied to the gross revenues of the TPPPS operating in San José, based on 2017 revenues, could generate an estimated \$14 million to \$15 million annually. This \$14 million to \$15 million would be new revenues to the City.

Other considerations may include a mix of the above scenario, plus additional elements. This may include increasing the Tax while increasing the number of tables and creating more flexibility for the cardrooms to compete with other regional competitors. The mix of these elements to produce scenarios for a potential ballot measure will dictate the estimated revenue to the City, but formulating final estimates now is not feasible as estimated revenues depend on the terms of the ballot measure. However, an increase of 1 percentage point in the tax rate from 15 percent to 16 percent is estimated to generate an additional \$1.25 million in Cardroom Tax revenues.

These estimates, however, may increase in any scenario that increases the number of gaming tables or amends the Municipal Code to increase competitiveness. As the Administration continues to refine a recommended ballot measure for Council consideration, additional analysis to estimate the expected new Tax revenues will be conducted.

### **EVALUATION AND FOLLOW-UP**

This item will return to Council on August 7, 2018 with additional analysis, polling data, and recommendations for Council consideration for placement on November 6, 2018 citywide ballot.

### **COORDINATION**

This memorandum has been coordinated with the City Attorney's Office.

### **COMMISSION RECOMMENDATION/INPUT**

No commission recommendation or input is associated with this action.

### **CEQA**

Exempt, Not a Project -- Feasibility and Planning Studies with no commitment to future actions  
Public Project number PP17-001.

/s/  
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/s/  
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