



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Lee Wilcox

**SUBJECT: PROPOSED CARDROOM
REVENUE MEASURE FOR THE
NOVEMBER 3, 2020 ELECTION**

DATE: July 23, 2020

Approved

Date

7/24/2020

RECOMMENDATION

Adopt a resolution of the City Council:

- (a) Calling and giving notice, on its own motion, for a Special Municipal Election to be consolidated with the Statewide General Election on November 3, 2020, to submit to the electors of the City of San José a measure to increase the cardroom tax on the gross revenues of cardrooms, add a new tax on the gross revenues of third party providers of proposition player services and increase the number of card tables with the following statement of the measure to be printed in the ballot:

To fund general San José services, including fire protection, disaster preparedness, 911 emergency response, street repair, youth programs, addressing homelessness, and supporting vulnerable residents, shall an ordinance be adopted increasing the cardroom tax rate from 15% to 16.5%, applying the tax to third party providers at these rates: up to \$25,000,000 at 5%; \$25,000,001 to \$30,000,000 at 7.5%; and over \$30,000,000 at 10%, increasing card tables by 30, generating approximately \$15,000,000 annually, until repealed?

- (b) Directing the City Clerk to, pursuant to Elections Code Section 12111, cause a synopsis of the proposed measure to be published at least one time not later than one week before the election in the *San Jose Mercury News*, a newspaper of general circulation within the City of San José, instead of printing the full text of the measure in the Sample Ballot;
- (c) Authorizing the City Council or any member or members of the City Council to submit a ballot argument in favor of the measure, pursuant to Elections Code Section 9282;
- (d) Authorizing the submittal of rebuttal arguments pursuant to Elections Code Section 9285;
- (e) Directing the City Attorney to prepare an Impartial Analysis of the measure pursuant Elections Code Section 9280; and
- (f) Directing the City Clerk to take all other actions necessary to place this measure on the November 3, 2020 ballot.

OUTCOME

Approval of this item will place the proposed cardroom revenue measure on the November 3, 2020 ballot.

The Administration has prepared the necessary materials, resolution, and ballot language for Council to place the above measure on the November 3, 2020 ballot. The Council meeting on August 4, 2020 is the last regularly scheduled Council meeting before the Santa Clara County Registrar of Voters deadline of Friday, August 7, 2020 for a measure to be placed on the ballot.

BACKGROUND

The City Council approved a cardroom ordinance in 1991-1992, which contained the provision for a Cardroom Business Tax (Cardroom Tax) to tax gross revenues from cardrooms located in San José. On June 9, 1992, the City Council amended the cardroom ordinance, increasing the tax rate schedule and expanding the games authorized. A gross revenues monthly tax schedule was established with taxes ranging from 1 percent to 13 percent of gross revenues. In 1993-1994, Council approved a revision to the cardroom ordinance, instituting a flat 13 percent gross revenues tax for all cardrooms located in the City with annual gross revenues in excess of \$10,000.

Title 16 of the San José 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. Section 16.04.030 defines "Expansion" to include an increase in: cardrooms or cardroom tables; use of slot machines or devices; and, any form of gambling which is not allowed under the Municipal Code on or before June 30, 1996, or which is prohibited under state gambling law on or before June 30, 1996.

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 generated 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 adoption.

In June 2010, voters approved Measure K, which increased the Cardroom Tax from 13 percent to 15 percent and increased the maximum number of card tables from 40 to 49 per cardroom. It is important to note that, while the State has authority over gaming regulations and the expansion

of gaming in cities such as San José, the State has no authority to review or comment on the City's Cardroom Tax.

On June 27, 2018 the Council directed the Administration to analyze and develop recommendations for extending the 15 percent Cardroom Tax to the two Third-Party Proposition Player Services (TPPPS) businesses operating in the City, engage the City's two cardrooms on alternative approaches, and return to Council in August 2018.

The Administration met with both San José cardrooms regarding a potential revenue measure for the November 6, 2018 ballot. Per Council direction, these conversations included:

- Increasing the Cardroom Tax rate;
- Increasing the number of tables each cardroom is permitted to have; and
- Extending the Cardroom Tax to those businesses providing TPPPS in the cardrooms.

On August 7, 2018 the Administration recommended the City "defer placement of a cardroom revenue measure on the 2018 Citywide ballot" and Council directed the City Manager and City Attorney return with ballot language and a resolution for Council consideration for placement on the March 3, 2020 ballot. This direction included engaging the City's two cardrooms during this process. The Administration has continued to engage the two cardrooms and work on a possible measure.

ANALYSIS

Proposed Cardroom Tax and Additional Tables

The City's current Cardroom Tax ordinance (Chapter 4.77) states that each cardroom permittee operating a cardroom with total annual gross revenues in excess of \$10,000 shall pay a monthly tax in an amount equal to 15% of total monthly gross revenues. This has been the tax rate since 2010 when Measure K was passed by voters. In 2018-2019, the Cardroom Tax generated approximately \$18.9 million to support City services. In addition, through February 2020, the 2019-2020 Cardroom Tax revenue was on pace to generate \$18.9 million. However, due to cardrooms not being operational during the County's shelter-in-place mandate in response to the COVID-19 pandemic, Cardroom Tax revenue is anticipated to total approximately \$13.5 million (a 28% drop from 2018-2019). The 2020-2021 Adopted Budget includes a 2020-2021 Cardroom Tax estimate of \$17.1 million; however, due to uncertainty regarding when the cardrooms can reopen, and the social distancing requirements that will be in place, this revenue estimate will continue to be closely monitored and a downward adjustment may be brought forward for City Council consideration later in the fiscal year.

The Administration recommends increasing the Cardroom Tax rate from 15 percent to 16.5 percent. The proposed tax increase would, if passed by a majority of the voters, take effect on January 1, 2021. The Administration also recommends increasing the number of card tables in

the city by 30 tables total (15 for each cardroom), and placing the Cardroom Tax increase, additional tables, and adding a new tax on the gross revenues of TPPPS entities (described below) on the November 3, 2020 ballot to be considered by San José voters. If the ballot measure passes and is implemented, approximately \$11 million may be generated on an annual basis from the increased Cardroom Tax on gross revenues (from 15% to 16.5%, \$2 million) assuming normal operations and the additional 30 cardroom tables (\$9 million). These estimates were derived based on 2018-2019 performance, therefore it is important to note, that this revenue may be significantly suppressed while cardrooms are closed or social distancing requirements are in place in order for the cardrooms to resume operations.

Third-Party Proposition Player Services

In 2018, the Council directed the Administration to develop recommendations for extending the Cardroom 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 banking the various games offered. State law and the San José Municipal Code do not allow the cardrooms to serve as the “banks.” These provisions are unique to California cardrooms; traditional house-banked games are only permitted in tribal casinos. Cardrooms offer “California games,” where the dealer role is rotated between the players at the table. Cardroom owners rely on TPPPS businesses to step into the dealer position to collect and pay-off bets when an individual player does not take the option of covering bets on the table. For decades this has been a State-approved alternative to offering traditional, banked card games.

The primary threat to this operating model for cardrooms throughout California is the State Bureau of Gambling Control (Bureau) making player-banked games illegal through regulatory changes. The Bureau released proposed regulatory changes in December 2019. However, there has been no movement on these regulatory changes due to the coronavirus pandemic, and the formal rulemaking process and timeline are still being determined. Potential legislation may provide a constitutional fix to the player-dealer rotation issue.

The Administration recommends taxing the gross revenues of TPPPS entities as follows:

Commencing on January 1, 2021, each TPPPS with total annual gross revenues in excess of ten thousand dollars (\$10,000) will pay a tax on its total annual gross revenues derived from its TPPPS activities in the City. The tax shall be paid monthly and calculated by multiplying monthly gross revenues by the applicable tax rate as determined by the total annual gross revenues as set forth below.

1. Where the total annual gross revenues are up to \$25,000,000, the tax rate imposed on the monthly gross revenues shall be five percent (5%);
2. Where the total annual gross revenues are \$25,000,001 to \$30,000,000, the tax rate imposed on the monthly gross revenues, including the annual gross revenues less than \$25,000,001, shall be seven and one-half percent (7.5%);

3. Where the total annual gross revenues are greater than \$30,000,000, the tax rate imposed on the monthly gross revenues, including the gross revenues equal to or less than \$30,000,000, shall be ten percent (10%).

For example, if the total annual gross revenues are \$28 million, then the entire \$28 million is taxed at 7.5%, beginning with the first dollar. The tax owed is \$2.1 million. If the total annual gross revenues are \$35 million, then the entire \$35 million is taxed at 10%, beginning with the first dollar. The tax owed is \$3.5 million.

The tax year for purposes of calculating total annual gross revenues of the TPPPS will be the fiscal year (July – June). For the initial tax period (January 1 – June 30) the gross revenues used for purposes of determining the applicable tax rate have been adjusted to reflect an initial 6-months tax period instead of a 12-months period. The first full tax year will begin with fiscal year 2021-2022.

If passed by voters, the new tax on TPPPS would take effect on January 1, 2021 and it is estimated that approximately \$4 million may be generated on an annual basis (\$2 million for the period from January 2021 through June 2021) assuming normal operations. These estimates were derived based on 2018-2019 performance, therefore it is important to note, that this revenue may be significantly suppressed while cardrooms are closed or social distancing requirements are in place in order for the cardrooms to resume operations.

Election Requirements

Posted with this memo is a resolution to submit to the electors of the City of San José a measure to enact a cardroom revenue measure. This resolution must be adopted and submitted to the Santa Clara County Registrar of Voters (ROV or Registrar) by August 7, 2020 for the measure to be included on the November 3, 2020 ballot. Staff is recommending the City Council approve the staff recommendations regarding additional items related to this election. Each of these recommendations are based on past practices in other elections, most recently in March 2020.

- Publishing a synopsis of the proposed measure in the *San Jose Mercury News*, a newspaper of general circulation within the City of San José, instead of printing the full text of the measure in the Sample Ballot;
- Authorizing a Council designee to submit a ballot argument in support of the measure;
- Authorizing the submittal of rebuttal arguments;
- Directing the City Attorney to prepare an Impartial Analysis of the measure in accordance with Elections Code 9280; and
- Directing the City Clerk to take all other actions necessary to place this measure on the November 3, 2020 ballot.

However, Council also has the option under the Elections Code to print the full text of the measure in the voter information guide, at additional cost; and/or decline to allow the submission of rebuttal arguments.

The City Clerk has fixed Wednesday August 11, 2020, at Noon as the deadlines for arguments to meet the deadline established by the ROV.

If the City Council wishes to allow rebuttal arguments, the City Clerk may accept rebuttal arguments from either the author(s) of a primary argument in support of or in opposition to a ballot measure, or any other person(s) authorized in writing by the author(s) to submit a rebuttal argument. Rebuttal arguments may not exceed 250 words and may be signed by no more than five (5) persons. The City Clerk has fixed Wednesday, August 18, 2020, at Noon as the deadline for Rebuttals to meet the deadline established by the ROV.

CONCLUSION

Exploratory poll results indicate that the potential cardroom revenue measure has a strong likelihood of being viable in the November 3, 2020 election. Given the serious needs San José faces, with a variety of issues, including disaster preparedness, homelessness, and fire station staffing, the Administration recommends that the Council place this potential measure on the November 3, 2020 ballot.

EVALUATION AND FOLLOW-UP

If the Council votes to place this measure on the ballot, the City Manager, City Attorney, and City Clerk will prepare and the City Clerk will deliver the measure to the Santa Clara County Registrar of Voters for placement on the November 3, 2020 ballot prior to the deadline of 5 p.m. on Friday, August 7, 2020.

Additional deadlines are:

- Ballot Arguments are due to the Registrar on August 11, 2020 (see above); and
- The City Attorney's Impartial Analysis and Rebuttals, if authorized by Council, are due to the Registrar on August 18, 2020 (see above).

The general election is Tuesday, November 3, 2020.

CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

PUBLIC OUTREACH

The City's survey research firm (Fairbanks, Maslin, Maullin, Metz & Associates or FM3) conducted an exploratory public opinion poll both online and by telephone in English, Spanish, and Vietnamese. The Administration also held discussions with the two cardrooms in San José. This memorandum will be posted on the City's Council Agenda website for the August 4, 2020 Council Meeting.

COORDINATION

This memorandum was coordinated with the City Attorney's Office, the City Clerk's Office, the City Manager's Budget Office, the Police Department, and the Finance Department.

COMMISSION RECOMMENDATION/INPUT

No commission recommendation or input is associated with this action.

COST SUMMARY/IMPLICATIONS

Summary of Potential Revenues

As displayed in the table below, should the ballot measure pass, approximately \$15 million in new General Fund revenues may potentially be generated on an annual basis. This revenue is anticipated to be generated on the increased Cardroom Tax (from 15% to 16.5%, \$2 million), the additional 30 card tables allowed (\$9 million), and the new TPPPS tax (\$4 million). It should be noted, however, that these revenue estimates have been derived from 2018-2019 actual performance, which is the most recent fiscal year not impacted by the COVID-19 pandemic. Therefore, uncertainty regarding when cardrooms will be operational again and the impacts that social distancing requirements will have on cardroom activity, the additional tax revenue may be suppressed for the immediate future. Additionally, due to the measure being implemented on January 1, 2021, 2020-2021 receipts will only reflect six months of the new tax revenue.

The Administration plans to bring proposed Title 16 amendments to City Council for consideration in late August 2020. These proposed amendments could potentially increase cardroom activity in the City, and over several years the potential revenue from the increased Cardroom Tax, additional tables and TPPPS tax may be approximately \$25 million annually.

Cardroom Revenue	Potential Annual Revenue
Cardroom Tax Increase (15% to 16.5%)	\$2 million
30 Additional Tables	\$9 million
Third-Party Proposition Player Services (TPPPS)	\$4 million
Total	\$15 million

Summary of Election Costs

For the November 2020 ballot, there are run-off elections for two City Council Districts, as well as potential ballot measures under City Council consideration, including this measure. The City Clerk's supplemental memorandum includes a breakdown for all potential November 2020 ballot costs. The total estimated cost for the election depends on the number of measures the City Council places on the ballot, the information included on the ballot, and the two run-off elections.

The 2020-2021 Elections and Ballot Measures appropriation totals \$2.7 million, which could fully fund the run-off election and two ballot measures. If additional measures are approved by the City Council for the November 2020 ballot, then additional funding would need to be identified as part of a future budget process, including the 2019-2020 Annual Report. It is important to note that the election costs are estimates only and will be revised based on the final fee schedule from the County Registrar of Voters and actual registration levels.

CEQA

Not a Project, File No. PP17-004, Government Funding Mechanism or Fiscal Activity with no commitment to a specific project which may result in a potentially significant physical impact on the environment. (City Manager)

/s/
LEE WILCOX
Chief of Staff
City Manager's Office

For questions, please contact Lee Wilcox, Chief of Staff, City Manager's Office at 408-535-4873.