

LAWFUL GAMBLING:

A Guide to Reform

Submitted to the Joint Legislative
Task Force on Lawful Gambling

by

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THE PROBLEMS

The problems in the lawful gambling industry are pervasive and varied. Abuses occur in every corner of the state: from Warroad to Worthington and from Marshall to Mountain Iron. No community is immune. It is common knowledge that:

- Nearly \$100 million in lawful gambling profits were generated in 1989 and there exists widespread abuse in the expenditure of those profits.
- There exists tax avoidance, tax evasion and a general lack of compliance with tax laws.
- Fraud, collusion and trickery exist throughout the gambling industry.
- Criminal penalties currently in effect do not effectively deter unlawful conduct.
- Gambling has become a vehicle to support private purpose rather than public good.

This proposal addresses each of these problems and provides a comprehensive package to restore public confidence in the gambling industry as well as in the state's ability to regulate it.

THE SOLUTION

I. LAWFUL PURPOSE

A. The definition

The definition of lawful purpose is permissive, confusing, and leads to inconsistent regulation. Under this proposal, the current definition of lawful purpose would be largely eliminated and replaced with language that restricts the contribution of gambling profits to charitable, religious, educational or governmental purposes. Those terms would be defined as follows:

"Charitable" means a contribution to:

- (1) any organization designated as exempt from the payment of federal income taxes under section 501(c)(3) of the Internal Revenue Code and in compliance with standards established by rule of the Gambling Control Board, unless the contribution is to a parent organization, foundation or affiliate of the contributing organization which provides money, grants, property or anything of value to the contributing organization; or
- (2) any individual or family suffering from poverty, homelessness or physical or mental disability provided the contribution is used to relieve the property, homelessness, or disability.

"Religious" means a nonprofit organization, church, or body of communicants, gathered in common membership for mutual support and edification in piety, worship, or religious observances.

"Educational" means a contribution to:

- (1) a public or private nonprofit educational institution registered with the Higher Education Coordinating Board, licensed by the Department of Human Services, or approved by the Board.

- (2) a scholarship fund for the purpose of defraying the cost of education to individuals, provided the funds are awarded through an open and fair selection process not controlled by the contributing organization; or
- (3) gender-balanced youth community and athletic activities.

"Governmental" means a contribution to a local, state or federal unit of government, except a law enforcement agency.

B. The ability to monitor and verify lawful purpose contributions:

The state must have the ability to monitor and verify all lawful purpose contributions. This proposal establishes a mechanism to monitor all lawful purpose contributions, verify the receipt of the contributions and, generally, ensure compliance with the law. Under this proposal, the monitoring of lawful purpose contributions would include the following changes:

- (1) The responsibility for receiving and reviewing all lawful purpose contribution reports would rest with the Gambling Control Board and copies should be submitted to the Department of Revenue and Department of Public Safety.
- (2) The lawful purpose contribution reports would contain at a minimum, the following information: (a) the name of the contributing organization; (b) the name, address, and phone number of the recipient; (c) a general description of the contribution and how the contribution meets the definition of lawful purpose; and (d) the date the contribution was approved by the organization.
- (3) Each recipient of gambling profits would be required to acknowledge receipt of the contribution, the amount of the contribution, the date on which the contribution was received, and provide a statement of how the contribution will be used to satisfy lawful purposes.
- (4) The recipient's acknowledgement would be submitted to the Board as an attachment to the organization's lawful purpose expenditure reports.

- (5) As recommended by the Attorney General, the Board would have the authority to require the registration of all recipients of gambling profits and the authority to revoke the registration for unlawful use of the proceeds.

II. LICENSING

A. Structure of the law

Currently, the provisions of the lawful gambling law governing licensing and exemptions from licensing are contained in various unrelated sections of the law. These provisions must be combined and located in a common section of the law.

B. Licensing of organizations

Under the current statute, the Gambling Control Board licenses each gambling premises operated by an organization. As a result, an organization conducting gambling at 100 different premises is required to submit 100 separate license applications and appear before the Board 100 different times each year. This process has led to a substantial duplication of effort, both on the part of the organizations and on the part of the Board.

This proposal permits the Board to license an organization rather than the gambling premises operated by the organization. Any organization conducting gambling at more than one premises would be required to obtain a premises permit from the Board staff. This process reduces by half the number of license applications annually processed by the Board.

C. Organization licensing criteria

The current licensing procedure does not provide an effective method for screening license applicants. More stringent licensing criteria are needed. This proposal augments the existing licensing criteria by requiring the applicant to prove it is a fraternal, religious, or other nonprofit organization which:

- (1) has a minimum of 15 "active" members;
- (2) for the most recent three years has been in existence as a registered Minnesota nonprofit corporation or an organization designated as exempt from the payment of income taxes by the Internal Revenue Service;
- (3) is not in existence solely to conduct gambling;

- (4) has no officer or director who has a criminal record or who has been subjected to disciplinary sanctions by the Gambling Control Board;
- (5) has a gambling manager who is licensed, bonded, and who has been an active member of the organization for at least the most recent six months;
- (6) has identified the lawful purposes on which it intends to expend gambling profits;
- (7) has not engaged in conduct which the Board determines is contrary to the public interest, welfare or safety or detrimental to the integrity of lawful gambling.

D. Licensing of gambling managers

Licensing of gambling managers serves two very important purposes. First, the licensing process ensures competency and integrity in the gambling manager. Second, licensing provides individual accountability for violation of law or rule. Under this proposal, licensing criteria would be established which would require that the gambling manager successfully complete the Gambling Manager Training Course provided by the Board and that no gambling manager may have been:

- (1) convicted of a felony within the past five years;
- (2) convicted of a felony involving fraud or misrepresentation or a crime involving gambling;
- (3) disciplined by the Board for a violation of law or rule which resulted in a license revocation; or
- (4) engaged in conduct which the Board determines is contrary to the public interest, welfare or safety or detrimental to the integrity of lawful gambling.

E. Registration of gambling employees

Prior to commencing employment, all employees engaged in the conduct of lawful gambling would be required to register with the Board, provide a photo and other descriptive information and obtain a picture identification card for display during all periods of employment.

F. Consultants

The integrity of lawful gambling is best ensured through organizational accountability. Under this proposal, the conduct of lawful gambling and assistance in the conduct of lawful gambling would be restricted to the "active members" of the organization, subject to a few specific exceptions. Those exceptions are limited to:

- (1) sellers of pull-tabs, tipboards, raffle and paddlewheel tickets and bingo paper; and
- (2) persons performing accounting, bookkeeping or legal services for an organization.

G. Distributors, manufacturers and bingo halls

The qualifications and restrictions imposed on these licensees must be clarified and refined. Most of these changes would be technical.

III. LOCAL TAXES

Local governments must be encouraged to actively participate in the regulation of lawful gambling. The 3% local tax allowed by current law for gambling enforcement is not sufficient to encourage a greater level of participation. Moreover, the re-definition of lawful purpose would preclude local law enforcement agencies from receiving direct contributions of gambling profits.

Under this proposal, the 3% local tax would be liberalized to permit local units of government to use a portion of the tax for general law enforcement purposes. In addition, the forfeiture provisions of the gambling law would be amended to permit local law enforcement and local prosecutors to benefit from the proceeds of forfeited gambling equipment.

IV. CRIMINAL PENALTIES

The Attorney General has identified several problems and shortcomings with the criminal provisions of the lawful gambling statute. The recommendations of the Attorney General's Report should be adopted. These recommendations include the following:

- (1) Impose felony penalties for engaging in "insider trading;"
- (2) Impose felony penalties for submitting false information in a license application or lawful purpose expenditure report;
- (3) Impose criminal penalties for unlawful purpose expenditure of gambling profits-- gross misdemeanor penalties for unlawful expenditures up to \$2,500, felony sanctions for anything over that amount;
- (4) Impose criminal penalties for alteration, modification or counterfeiting of tickets and for presentment of such tickets -- gross misdemeanor penalties if the face value of the ticket is \$200 or less, felony sanctions if it is more than \$200;
- (5) Impose across-the-board gross misdemeanor penalties for all violations of the lawful gambling statute that do not specifically provide a different penalty.

In addition, the Division of Gambling Enforcement has suggested the following amendments to the criminal laws governing gambling:

- (1) create a universal definition of "gambling device" in Minnesota law.
- (2) provide for the suspension or revocation of all licenses for the illegal operation or possession of a gambling device.
- (3) clarify the definition of "lottery" under the criminal law to provide guidance to retailers, advertisers and others who engage in promotional activities involving games of chance.

V. DISCLOSURE

Organizations must be required to publicly disclose to pull-tab and tipboard players the major prizes that have been won in any pull-tab or tipboard game. This provision, coupled with enhanced criminal penalties, will help eliminate the problem of insider trading.

VI. TECHNICAL CHANGES

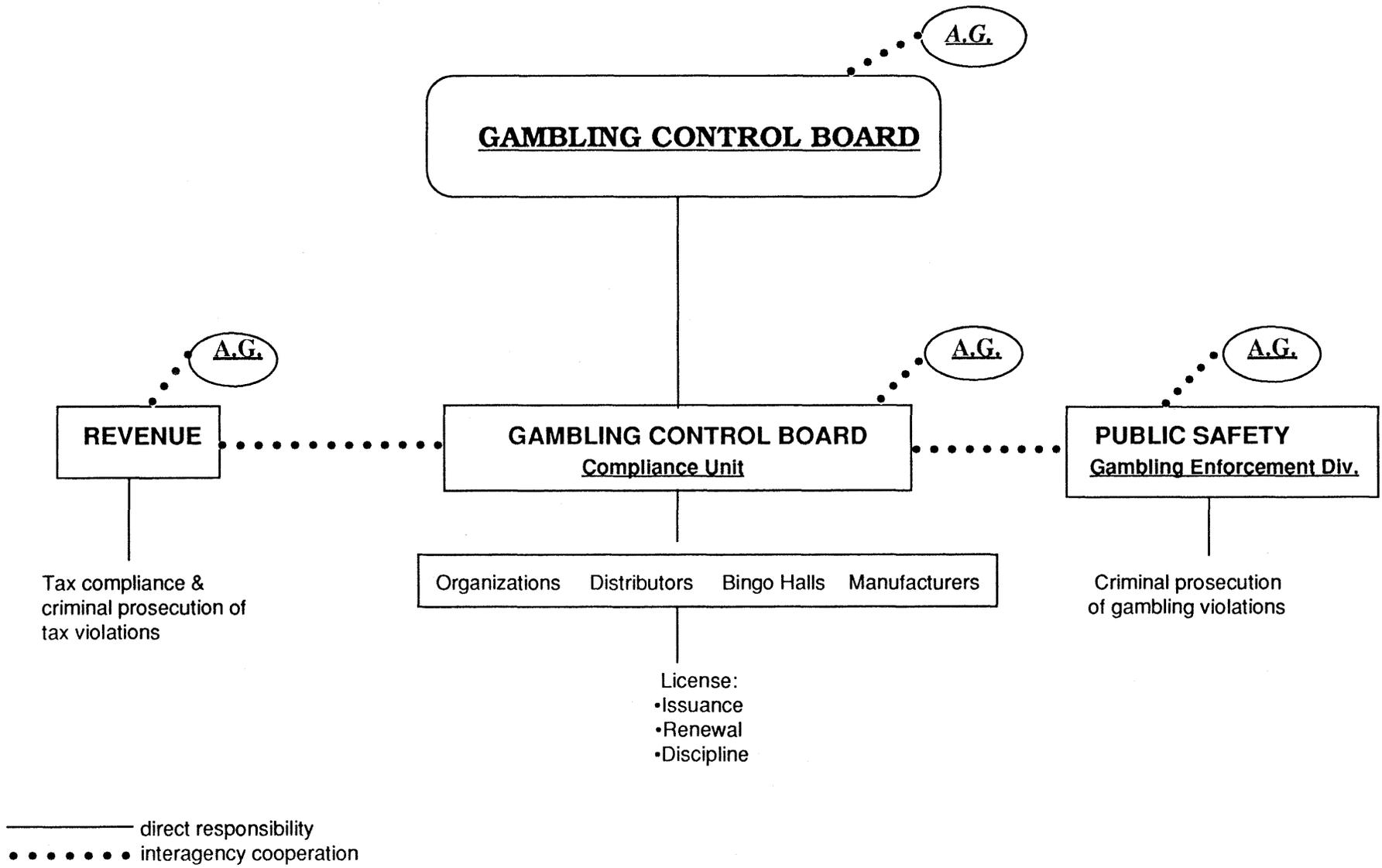
Technical changes need to be made to many of the provisions of the lawful gambling statute. In summary, these changes include the following:

- (1) definitions;
- (2) the powers and duties of the Gambling Control Board;
- (3) registration of gambling equipment;
- (4) leases and equipment storage;
- (5) records and reports;
- (6) compensation;
- (7) contraband and forfeiture; and
- (8) licensing exclusions.

VII. HUMAN AND FINANCIAL RESOURCES

Gambling in Minnesota is governed by the Division of Gambling Control, which includes the Director and the Gambling Control Board. Additional regulation is performed by the Department of Public Safety, Division of Gambling Enforcement (background and criminal investigations) and the Department of Revenue, Special Taxes Division (tax collection and tax compliance for lawful gambling).

LAWFUL GAMBLING COMPLIANCE AND ENFORCEMENT



The Structure of Lawful Gambling Regulation

The structure, although in its infancy, embodies an effective distribution of regulatory responsibility. No changes in the regulatory structure are needed. However, a clear delineation of function is essential to establishing an effective regulatory system. The following charts summarize the various functions of the four agencies that regulate lawful gambling as contemplated under this proposal.

Division of Gambling Control	Department of Revenue	Department of Public Safety	Attorney General
<ul style="list-style-type: none"> •Regulation of lawful gambling •Provide technical assistance to licensed organizations, distributors and manufacturers •Registration of gambling employees •Compliance review •Licensing of organizations, distributors, bingo halls, manufacturers, and gambling managers 	<ul style="list-style-type: none"> •Limited tax audits •Full tax audits •Bingo audits •Financial and investigative audits 	<ul style="list-style-type: none"> •Enforcement •Background investigations for the State Lottery, the Racing Commission, and the Gambling Control Division •Advise, assist, and educate local law enforcement agencies •Indian gambling regulation 	<ul style="list-style-type: none"> •Legal advice on laws and rules to all gambling regulatory agencies •Legal advice on licensing and rulemaking •Handling of all administrative proceedings to suspend or revoke licenses •Advise, assist, and educate local prosecutors

Lawful Gambling - Human Resources Request

This proposal embodies a request for 106 additional positions to be distributed among the four state agencies responsible for the regulation and enforcement of lawful gambling. The positions will be allocated as follows:

	Current Staff FY90-91	Resource Request	Total
Division of Gambling Control	13	57	70
Department of Revenue (Lawful Gambling Unit)	13	25	38
Department of Public Safety	12*	21	33
Attorney General	2.5	2.5	5

*The Division of Gambling Enforcement has a complement of 12 positions but received funding for only six.

These additional positions represent a cost of approximately \$6.2 million or .5% of the total lawful gambling gross receipts generated in 1989. Currently Minnesota ranks first in the nation in gross lawful gambling receipts, and near the bottom in regulatory and enforcement resources. The table below lists the gross lawful gambling receipts, regulation and enforcement budgets and staff size for six states. The last two columns are projections for Minnesota's regulation and enforcement budget if the same percentage of gross lawful gambling receipts were spent as in the other states.

State	Gross Handle	Reg. Budget	% of Gross	Staff	For Minnesota	
					Budget	Staff
MA	\$257,600,000	\$3,400,000	1.32%	51	\$11,305,000	170
WA	500,481,579	4,100,000	0.82%	97	7,017,000	166
NE	189,824,118	1,260,855	0.66%	34	5,689,000	153
MI	257,000,000	1,500,000	0.58%	23	4,999,000	77
TX	469,365,031	2,284,000	0.49%	25	4,168,000	46
ND	215,410,000	800,000	0.37%	15	3,181,000	60

Compared with the regulatory and enforcement budgets of other states, Minnesota lags far behind. These additional resources are critical to effectively regulate the gambling industry.

APPENDIX A

DEFINITIONS

Audits:
(Revenue)

Audit is a descriptive term used to define several separate but inter-related activities. Accordingly, it is necessary to differentiate between the various types of audits.

Limited tax audit: Limited tax audit is a review of an organization's financial records for a two-month period. The audit compares the organization's monthly tax reports with the organization's bank accounts, meeting minutes, check register and the other income and disbursement documents to verify the accuracy of the monthly gambling tax reports. A limited tax audit takes approximately one week.

Full tax audit: If an organization fails to file its monthly gambling tax reports or if a limited tax audit reveals significant problems which may affect the organization's tax liability, a full tax audit is performed. A full tax audit involves the review of all financial and reporting documents for the entire period of delinquency or for the period during which problems are discovered. The audit may cover a two or three year period. A full tax audit takes approximately one month.

Financial and investigative audit: A financial and investigative audit consists of a complete and extensive review of an organization's financial records and other documents, including a review of all of the financial transactions of the organization. A financial and investigative audit consists of a review of the organization's general gambling records and will focus on missing or unreported funds. A financial and investigative audit takes approximately two months.

Bingo audit: A bingo audit is an on-site inspection and review of a minimum of five bingo occasions conducted by an organization. A bingo audit requires the creation of a base period of activity and involves a comparison of the base period to the information generated during the review of the five bingo occasions. A bingo audit takes approximately one month

Compliance:
(Gambling Control
Division)

Compliance consists of a review of the activities of an organization, bingo hall owner/lessor, distributor or manufacturer to ensure adherence to all laws and rules governing lawful gambling. Compliance includes the ability to verify license application information, lawful purpose expenditure reports, sales of gambling equipment, adherence to game rules and procedures, use of lawful gambling equipment, and all other activities that have a bearing on the licensee's fitness to be engaged in lawful gambling. Compliance violations result in an administrative proceeding to suspend or revoke the license, to impose a civil fine, or to issue a cease and desist order.

Compliance review: A compliance review consists of an on-site inspection of the organization's gambling activity to ensure compliance with all laws and rules governing lawful gambling. A compliance review also includes a comprehensive review of an organization's lawful purpose contributions. An on-site compliance review, if performed by persons familiar with the lawful gambling rules, takes approximately four hours. A lawful purpose review will take from one week to one month, depending on the scope and complexity of the review.

Enforcement: Enforcement consists of the investigation and prosecution of criminal violations of the laws governing lawful and unlawful gambling.
(Public Safety)

Licensing: Licensing consists of the issuance of licenses to gambling participants who meet certain qualifications and the suspension and revocation of those licenses for failure to comply with law or rule.
(Gambling Control Division)

Regulation: Regulation is the ability to control and monitor the lawful gambling industry through licensing of participants, review of gambling activities and reports, monitoring of proceeds and compliance with all laws and rules.
(Gambling Control Division)

Minnesota Lawful Gambling License Renewal Attachments

Reminder: Please attach the following documents to your renewal applications and the following information.

- 1) Compensation schedule, form CG205. Only one compensation schedule is required for the organization as a whole. The compensation schedule pertains to the wages that are paid to the employees of the organization who conduct lawful gambling. If your employees are volunteer, indicate \$0 on the form. Compensation must be approved by the organization.
- 2) Registration of storage space. Indicate the address of your organization's storage space of its gambling supplies/equipment.
- 3) Internal controls, form CG201. Must be on the form provided by the Board. Only one set of internal controls is required for the organization as a whole.
- 4) If leasing your premises, the lease must be on a lease form provided by the Board, form CG202.

An organization may not pay rent to itself or its holding company.

If the premises is not being leased from the legal owner of the premises, submit a copy of the lease between the owner and sublessor which shows that the legal owner permits subleasing.

- 5) If leasing your premises, include a sketch of the leased gambling premises with dimensions and total square footage leased.
- 6) If conducting bingo, indicate the days and times (beginning and ending hours) of your bingo occasions.
- 7) **All organizations** are required to provide proof of their nonprofit status. This may be either a copy of nonprofit incorporation from the Minnesota Secretary of State OR a letter from the IRS declaring income tax exemption for the most recent three years.

Organizations which are chartered must provide one of the above plus a copy of their charter.

Catholic churches should submit a copy from the archdiocese directory listing their organizations.

An organization which is an affiliate may not be licensed.

- 8) Current expense calculations must be on file with the Gambling Control Division.

1/10/90
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