GAMBLING and the LAW

GSN Ex. 1004
GSN v. Bally Gaming
U.S. Patent 5,816,918

I. Nelson Rose

19.95

Gamblers are, for the most part, a well informed group. Thousands of books have been written on the correct odds and strategies for all forms of gaming. But if a gambler has a legal problem—well, that's a different story.

Until Professor Rose wrote this book there was virtually no literature, or help, available for the person who had a legal problem whether it was from being blacklisted, winning the lottery or hitting it big on the slot machines in Las Vegas.

Written in a style that anyone can understand, this book explains such issues as:

- Taking gambling losses and expenses off your taxes.
- How to avoid paying gambling debts.
- What to do if you feel you are cheated.
- Is your home poker game legal?
- What to do if you are arrested.
- Your rights in a casino.
- Can you count cards legally?
- How to keep from being blacklisted by casinos.
- Getting a gaming license and when you need one.
- Can you make gambling legal where you live?
- Reducing taxes if you win big in a lottery.
- Legalities and status of bingo.
- When merchant giveaways become a lottery.
- Are fishing jackpots really lotteries?
- Future of charity gambling.
- How much can the IRS withhold from your winnings?
- A 250-year-old law that still affects gamblers.
- Must a casino or lottery pay you a big win?
- Where to find the law.
- Why does the FCC consider craps a lottery?
- Can your wife sue to get your gambling losses back?
- If a sweepstakes requires a stamp, is it a lottery?
- Are video lotteries the wave of the future?
- Can you own a slot machine?
- Do illegal bookies have to pay excise tax on bets?
- Must illegal gamblers register with the government?
- Must casinos withhold on keno and slot winnings?
- Can a casino collect from you in your home town?
- How $50,000 Indian bingo prizes came about.

Gambling and the Law

Gambling and the Law

Gambling and the Law

by I. Nelson Rose
Professor of Law

Published by Gambling Times Incorporated
1018 N. Cole Ave., Hollywood, California 90038

Distributed nationally by Lyle Stuart, Inc.
120 Enterprise Ave., Secaucus, New Jersey 07094

Copyright (c) 1986 by Gambling Times Incorporated

All rights reserved. No part of this publication may be reproduced or transmitted in any form, or by any means, electronic or mechanical, including, but not limited to, photocopy, recording, or any information storage and retrieval system without written permission from the publisher.

Requests for permission to make copies of any part of the work should be mailed to: Permissions Department, Gambling Times Incorporated, 1018 N. Cole, Hollywood, California 90038

ISBN 0-89746-066-9

First Edition

Printed in the United States of America

Dedication

This book is dedicated to my wife, Audree.
With your love and support anything is possible.

Note

While the author is a professor of law and an attorney licensed to practice in California and Hawaii, it is understood that the publisher is not engaged in rendering legal service. This book is designed to provide accurate and authoritative information on the gambling laws of the United States. However, neither the author nor the publisher can be held responsible for any errors of fact or law. This book is not a substitute for analysis of the reader's particular problem by a trained practitioner. If legal advice or other expert assistance is required, the service of a competent lawyer should be sought.

Adapted from a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers.

Contents

Acknowledgement/*xi*

Introduction/*xiii*

CHAPTER ONE

The Spread of Legalized Gambling/1

CHAPTER TWO

Where Does the Law Come From/22

CHAPTER THREE

Hold 'em Poker in California/33

CHAPTER FOUR

The Federal Law of Gambling/43

CHAPTER FIVE

Legal Gambling's Right to Advertise/55

CHAPTER SIX

The Common Law of Gambling/68

CHAPTER SEVEN

Slot Machines, Video Poker and Video Lotteries vs the Law/83

CHAPTER EIGHT

How to Find the Law/96

CHAPTER NINE

Gambling and Taxes/109

CHAPTER TEN

Taking Gambling Losses and Expenses off Your Taxes/124

CHAPTER ELEVEN

Gambling Debts and the Law/142

CHAPTER TWELVE

Collecting Gambling Debts Across State Lines/155

CHAPTER THIRTEEN

Gambling and the Criminal Law/167

CHAPTER FOURTEEN

Licensing—the Other Side of the Tables/178

CHAPTER FIFTEEN

Regulating Card Counters/194

CHAPTER SIXTEEN

Current Issues in Gambling Laws/207

CHAPTER SEVENTEEN

New Currency Reporting Regulations/221

CHAPTER EIGHTEEN

Conclusion/243

Notes/245

Cases/272

Resources/289

Acknowledgements

I would like to thank the many individuals and institutions that helped make this book possible.

My research assistants, Beverly Stane, Patricia Kozlowski, and Christine J. Wilson, law students at Whittier College School of Law, helped me find the cases and statutes that make up the body of gambling law.

My colleagues and the staff at Whittier College School of Law were most helpful in supporting my work and in aiding me in completing this massive project. I would particularly like to thank Dean John FitzRandolph for recognizing that the law of gambling can merit serious academic study, Professor J. Denny Haythorn for putting together a law library and the research tools necessary for this study, Professor David Welkowitz for his assistance on legal gambling and the commercial free speech doctrine, and Professor Richard Gruner for his work on constitutional issues relating to corporate casino licenses. I would also like to thank my students, who always inspire me with their new ideas and interest.

Gambling Times has worked with me from the start in conceiving this project and putting the final product together. Some of the ideas in this book first appeared in my column, "Gambling and the Law," in *Gambling Times Magazine*. I would particularly like to thank my publisher, Stanley Sludikoff; my editor, Len Miller; and the assistant editors who worked so hard putting together a monthly magazine.

I drew upon conversations with and readings from a number of experts in academia who have studied gambling. Professor William Eadington of the University of Nevada, Reno, has spent years studying this field and has almost single handedly made the field a respectable area for academic research. Professors William Thompson of the University of Nevada, Las Vegas, and John Dombrink of the University of California, Irvine, have brought new insights into the spread of legalized gambling. Eugene Christiansen offers the unique perspective of an academic study coupled with real world experience from his position with New York City's Off-Track-Betting Corporation. I would also like to thank Professor James Smith, Pennsylvania State University; Professor Tom Hammer, Glassboro State College; Professor Jack Samuels, Montclair State College; Professor Tom Harris, University of Nevada, Reno, for taking the time to discuss ideas with me, many of which ended up in this book.

I have also relied heavily upon my discussions and the works of experts from outside academia; the real world. Howard Schwartz, who runs the Gambler's Book Club in Las Vegas, knows more about gambling literature than anyone else alive. James E. Ritchie, practicing law in Washington D.C., was Executive Director of the Commission on the Review of the National Policy Toward Gambling, and is still one of the leading gaming lawyers in the country. Rufus King, also of Washington D.C., informs me that he is semi-retired, but he remains the nation's leading legal expert on amusement and gambling devices. Wilbur Duberstein, of San Ramon, California, is General Counsel to the California Card Club Owners Association and is one

of the few practicing lawyers who understands how gambling law works in theory and practice. I would also like to thank George Hardie of the Bicycle Club in Bell Gardens for his continued interest in legal gaming's rights under the law.

Vernon G. Kite, Jr., of Harrah's Atlantic City, sent me copies of his graphs illustrating the growth of legal gambling, which are included in Chapter One. West Publishing Company gave me permission to reproduce the case in Chapter Twelve, *Dorado Beach Hotel Corp. v. Jernigan*, 202 So.2d 830, with their copyright.

Most of all I want to thank my wife Audree who helped me literally put together my manuscript, and who was always there to support me through the bad times as well as the good.

Professor I. Nelson Rose

Introduction

This book is unique in many ways, and one of the most surprising things about it is that it should be unique. By the most conservative estimates, gambling in the United States is a one hundred billion dollar a year business. The total amount bet at legal games alone exceeds $147 billion; and the amount bet at illegal gambling is almost impossible to estimate.

Yet, there has never been a book on gambling and the law for the player; or, for the casino, racetrack owner, or even lawyer, for that matter. There are a few scattered articles, usually of a highly academic nature for specialists, but nothing that will help the casual or serious player, on either side of the tables, in coping with the law.

This book is designed to help you cope with the law.

And you must be concerned with the law, even if you only place one bet a year. The law is involved in every aspect of gambling, and the consequences for the unwise or the unwary can be drastic. The legal gambling industry is subjected to regulation and government scrutiny that is as tough as that given any other business in the country, including the building of atomic reactors and safety inspections on airlines. A single mistake could mean the loss of a license worth hundreds of millions of dollars.

The illegal gambling industry is obviously subjected to as much scrutiny as law enforcement can muster; and a mistake here on the part of the operator means a fine or jail, possibly for a very long time.

In between the legal and the illegal industries there are all the rest of us; and ignorance of the law by even the most infrequent player can mean a loss of money, time, and possible criminal sanctions, including a fine and jail sentence, not to mention public embarrassment.

Tens of thousands of people are involved directly with gambling on a regular basis. Legal gambling includes not only multi-million dollar casinos with thousands of employees ranging from the casino manager, through the dealers and bartenders, to the janitors and gardeners. There are other legal establishments that everyone recognizes as gambling: horse and dog racing tracks, jai alai frontons, legal card

clubs, and lotteries have become essential parts of the economy for many cities and states. But there are other forms of legal gambling that may not be thought of as gambling: the church or charity that depends on bingo revenue may not like to think that it is running exactly the same type of game as a casino, but it is; mail order sweepstakes ("You may already be a winner") and fast food chains with rub-off cards for instant winners do not like to be told that their advertising gimmicks are identical in the eyes of the law to a slot machine, but they are; the insurance industry and commodity traders do not like to be reminded that their businesses were outlawed until very recently (and in some cases are still illegal) as forms of sinful gambling.

The law is also important in legal gambling to the player who wants to know if he can stop payment on the check he wrote the casino, to the lottery ticket winner who does not want to give all of his winnings back in the form of taxes, to the investor who wants to know if gambling stocks are riskier than other business ventures. If the casino or bingo hall refuses to pay, can you collect? Can you take your travel expenses off your taxes if you count cards? Can you even count cards, or can the casino legally bar you from playing?

Illegal gambling involves much greater numbers of people than its legal counterpart, and probably much more money. There are full-time bookies (sports and far off the track betting) and numbers runners (illegal lotteries that still flourish in the ghettos and barrios), and the police and prosecutors who try to control them. But there are also part-time operators who run sports cards or occasional poker or craps games, from the office pool during the Super Bowl to the hotel room floating craps game. And there are the bettors. If you are caught in a raid can you get off by pleading you were only a player? Can you get back your money? Are you facing a misdemeanor—a fine and a night in jail—or can they make it, literally, into a federal offense? What should you do?

In between the legal and the illegal are tens of millions of players who are involved with the law on a regular basis, and may not even know it, until it is too late. Do you have a regular Tuesday night poker game at your place? And does the game have a regular kitty, each player chipping in money for refreshments and maybe something for the house? Do you accept personal checks when a player is short? If the check bounces can you collect? If you are arrested can you say this was only a social game? Can you afford a lawyer or 30 days in jail? What should you do?

Does the neighborhood bar have a video poker machine? Does the bartender pay off jackpots in cash? If the bar is raided will the bartender lose his license? Will he go to jail? Will you? What should you do?

This book is designed to help answer these questions, and others that you may not even have thought to ask until you find yourself in a lawsuit. By reading about the way the law affects gambling and gamblers, particularly gamblers who have gotten in trouble, you should, with any luck, be able to avoid lawsuits and lawyers.

In it you will find information on the following:

- How to take gambling losses off your taxes.
- How to collect on gambling debts.
- What to do if you feel you have been cheated.
- How to tell if what you are doing is legal.
- What to do if you are arrested.
- Your rights in a casino, to count cards at blackjack, to stop payment on your checks, to avoid being blacklisted.
- How to get a license, and finding out when you need one.
- How to make gambling legal where you live.

I will use actual cases to show you how the law works, and what the gambler must know to come out ahead. We'll discuss some history and background, because, unless we know where we came from we will not be able to tell where we are going. But the main focus will be on explaining what is going on in gambling law today in the United States, with concrete examples and practical recommendations.

Although most gamblers are male, I realize that there are millions of women who play occasionally or regularly, or whose jobs depend on gambling, or who are married to gamblers. All of these women should be concerned about gambling law. For the sake of convenience I will refer to a gambler as a "he" rather than use some grammatically awkward form like "he/she" or "when he or she plays his or her cards . . ."

First, however, a word on what this book is not: It is not legal advice. Although I have tried to make this book both informative and interesting, it is not designed to take the place of a lawyer.

IF YOUR MONEY OR FREEDOM IS AT STAKE YOU MUST IMMEDIATELY CONSULT AN ATTORNEY.

Please reread the two paragraphs above this one. These statements are there for many good reasons, not the least of which is that I do not intend to be sued by anyone who thinks they can rely on this book instead of going to a lawyer. Only a lawyer can help you with your problem. Every state, city and county has its own law, and I cannot tell you what the law is where you live. Every legal situation involves a unique set of facts, and it is possible for one minor fact to make the difference between collecting and not collecting your money, or between being found guilty or innocent of a crime.

I am an experienced attorney and a professor of law. However, I cannot, by law, give legal advice through this book. Even if the law allowed me to give you advice I would not do it without knowing the facts of your particular situation and the law of your state at this particular time. The law changes slowly, but it does change; twenty-five years ago there was not a single legal lottery in the United States, today it is almost impossible to find a state outside the South and Midwest that does not have

a state lottery. Three years ago a Las Vegas casino could not sue you, even in a Nevada court, if you refused to pay a gambling debt; today the casinos definitely have the right to sue, at least in their home courts.

And the gambling laws vary from one location to another to a greater extent than in any other field of law. Unless you live in Nevada, Atlantic City, Puerto Rico, or some of the provinces of Canada you will not see legal casinos in your city. The variations do not even have to be from state to state; you can play draw poker legally in a licensed card club in Gardena or Bell Gardens, cross the city line into Los Angeles and the same game will send you to jail for up to one year.

You must speak to an attorney who can find out what the law is in your jurisdiction and who can ask you questions about your particular situation. And you must go immediately to a lawyer because you may lose all of your rights if you fail to act in time.

Since this book is not designed to be a legal treatise I have eliminated footnotes and most citations from the text. I have included citations only after direct quotations, or when necessary to avoid confusion. The section entitled "Notes" that appears toward the end of the book contains detailed citations for the other cases and statutes mentioned in the text, as well as references to additional outside research material. The Notes section also contains some miscellaneous comments that I considered too dry, academic, and peripheral to include in the main text.

It is always a difficult choice for the writer to decide whether some bit of information or insightful comment is important enough to include in the main text, or not that important but still worthy of inclusion in the notes, or not important at all. It is even more difficult for the reader to decide what to do about the collection of possibly important comments lurking in the notes: should you read the entire chapter and then the notes, or should you read a paragraph or sentence at a time, flipping back and forth from text to notes to make sure you do not miss any words of wisdom? My personal preference is to read the entire chapter and then the notes, but feel free to flip back and forth.

The reader who is interested in following up on a particular topic should start with the Notes section that corresponds to that chapter in the text. I suggest that anyone interested in doing their own additional research read through the entire book first, particularly the various sections in the back. You should be warned, however, that, except for the legal references, much of the material cited is extremely difficult to find.

I have also included another section that I think will be of general interest to anyone reading this book, but, will be of special interest to the reader who wants more on any particular subject in the field of gambling law. The section is entitled "Cases" and consists of capsuled summaries of most of leading gambling cases, including citations. Virtually every one of these cases can be found in any law library. The system of citations is briefly explained in Chapter Eight, so that you do not need to be a lawyer to find and read any case of interest to you.

For the reader who wants more information in general, I have included a large number of important reference works relating to gambling in a section entitled "Resources." It is with finding these works that the researcher will have the most difficulty, simply because it is almost impossible to find all of these works in one place, outside of the University of Nevada at Las Vegas, the Library of Congress in Washington D.C., and the author's private library. Many of these works, including the government publications, are out-of-print, and thus unavailable, even from the publishers.

When I first started studying the law of gambling in 1975 I was able to read literally everything that had ever been published on the subject. This was truly unique, in no other field of law was it possible to read all the literature available; imagine trying to read everything ever written on the death penalty, let alone on the crime of murder.

Today, however, the situation has changed. Gambling has not only become big business but the study of the impact of gambling has become a respectable topic for study by sociologists, psychologists and even law professors. The popular press has also discovered gambling; *Gambling Times* Magazine has a readership in the hundreds of thousands. I now find it difficult to keep up with the current periodicals and professional papers discussing gambling in America.

Although I have tried to be complete in my survey of the literature, it is possible that an important work may have been accidentally omitted. To my colleagues and those who have gone before I apologize in advance for any such accidental oversight; no slight is intended.

I welcome any comments or suggestions for material to include in future editions of this work.

Finally, it should be clear that the conclusions and legal analyses drawn in this book are entirely my own. Other experts may disagree with my interpretations. Gambling is as old as man, yet has only been subjected to serious study in the last few years. I cannot pretend to give the final word on this complex legal, economic, social and psychological phenomenon. If I shed a little light on the subject this book will be a success.

Professor I. Nelson Rose
Whittier College School of Law
Los Angeles, California, 1986

1
The Spread of Legalized Gambling

A third wave of legalized gambling is sweeping the nation. Like dominoes, state after state is turning to legal gambling as a source of revenue. Other states are loosening their laws to allow social games to be played without fear of criminal penalties. Bingo and card rooms are booming and video lotteries and poker machines are being placed in bars throughout the country. Each year the voters are asked to decide whether lotteries, race tracks and even casinos should be allowed in their locales. Public opinion polls show a landslide in favor of more legal gambling.

This is not the first time gambling fever has swept the nation. The first wave of legal gambling started during the colonial period and did not die out until the decades immediately prior to the Civil War. The colonies were financed in major part by public lotteries, and such notables as George Washington, Benjamin Franklin and Thomas Jefferson sponsored private lotteries. Even such a prestigious institution as Harvard University received considerable funding from lotteries in its early days.

The second wave of legal gambling started with the Civil War. The South had been devastated by the war and looked upon gambling, and in particular lotteries, as a painless way to raise needed funds.

Unfortunately, the second wave broke in scandal after scandal; the largest and most notorious being the Louisiana Lottery scandal of the 1890s. The blatant attempt by the promoters of the Louisiana Lottery, a privately owned company, to buy the Louisiana state Legislature resulted in the imposition of stiff federal laws and state constitutional restrictions.

We are still paying today for those scandals of a hundred years ago. The federal government still has a law on its books prohibiting almost all advertising of lotteries, which the Federal Communications Commissions uses to keep legal casinos and bingo games off of radio and television. Voters in the 1800s were so opposed to legal gambling that they not only passed laws prohibiting the games, they also tried to nail

the prohibitions down by including anti-gambling language in their state constitutions. When the third wave of legalization began in 1960 it was often necessary to amend the state constitutions, a difficult task, to remove language such as California's "The Legislature has no power to authorize lotteries and shall prohibit the sale of lottery tickets in the State." Calif. Const. Art. IV, Section 19(a).

The third wave started in 1964 with the New Hampshire Sweepstakes. It is hard to believe today that less than 25 years ago there was not a single legal lottery anywhere in this country. New Hampshire opened the doors with the first state lottery of this century. It was followed in a few years by New York and New Jersey, and then a tidal wave of other states.

Today more than 20 states and the District of Columbia run state lotteries. The games vary from once a week drawings to daily numbers games to instant winners. In 1984 the voters of four more states voted to join the wave: California, Missouri, Oregon and West Virginia, and the Iowa legislature added yet another new state to the list in 1985.

The latest thing in lotteries is the video lottery machine. Nebraska and Illinois are experimenting with putting the machines in public areas, and other states are carefully watching the results. The typical video lottery is simply a sophisticated slot machine: a player puts his money into the machine and the results are determined by chance. Some of these machines allow the players to play a game, but the outcome is not within the player's control. Cash prizes of up to $600 can be paid by the bartender or other proprietor on the spot; larger prizes are paid by the state lottery commission.

Video lotteries are not the only recent technological breakthrough in legal gambling. Video poker machines can be found from Massachusetts to Hawaii and are subject to constant legal challenge from the police. Video blackjack machines have forced the highest courts of many states to try and determine what makes a device, like Space Invaders, acceptable while similar electronic games smack of illicit gambling.

The third wave of legal gambling has swept in the charities, and in one unusual development, the Indian tribes. Bingo is a multi-hundred million dollar a year business. State legislatures meant to protect their local charities from being busted; so they made playing of bingo and similar games legal, if the money goes to a charitable organization. The legislators underestimated the inventiveness of the gambling operators, and the extent of the population's desire to gamble. The days of the little church basement bingo games are long gone. Today there are cavernous casinos, called bingo halls, where the operators and players stay the same, but the charities rotate.

The new concept of rotating charities is used with other games. The province of Alberta, Canada, has full-fledged casinos playing $1 to $25 blackjack. North Dakota has $2 blackjack. And New York has wide-open "Las Vegas Nights," with all the profit going to various rotating charities.

The Indian tribes found that they did not have to rotate charities as an excuse from wide-open gambling; the tribe is its own charity. Two federal courts of appeals have ruled that a state can make a game illegal and therefore playing the game is a criminal violation both on and off the Indian reservation. However, once the game is made legal the state government has no power to tell the Indian tribes what they cannot do on their own land. Thus was born Indian Bingo—Indian tribes are opening giant bingo halls offering prizes worth thousands of dollars, and are completely beyond the control of the states.

The third wave of legalized gambling includes the tracks. The tracks can be seen as a separate mini-wave that has followed the same patterns and preceded the recent big third wave. At the beginning of this century racing and bookmaking had been outlawed everywhere, except Maryland, Kentucky and New York. But the Depression of the 1930s, like the Civil War 70 years earlier, forced the states to look to means other than taxes to raise desperately needed revenue. As noted expert Rufus King put it, "[I]n the period between 1930 and 1940, the number of states with regulated tracks jumped to eighteen, and in the following decade, to twenty-five."

Missouri voted in 1984 to join the parimutuel crowd. A large majority of the states allow betting on races. Betting on horses at the track is now allowed in 36 states and betting on the dogs is legal in 15 states. One of the indications of the spreading wave is the drive for off-track betting (OTB). Twenty-two states now allow OTB, with New York leading the way into a billion dollar market.

Jai alai, the fast-action Basque game similar to handball, spread from Florida to Connecticut, Delaware, Rhode Island and Nevada. The MGM Grand in Las Vegas recently closed its fronton and scandals in other states have hit the game fairly hard. Jai alai promoters have had a hard time convincing the public that human jai alai players are as uncorruptable as horses; although, they have succeeded in having jai alai exempt from the laws prohibiting sports betting. In jai alai the bets are placed in a parimutuel pool, like at the track, and are not bet against a bookie, like most sports betting.

The most recent developments in the third wave have been state lotteries, video machines, commercial sweepstakes, gambling tournaments, charity and Indian bingo, and the rapid growth of legal card rooms, particularly poker.

Nine states allow legal, commercial card rooms, and the game of poker has seen such interesting developments in recent years as tournament plays, including the nationally televised World Series of Poker, played with the relatively new game of Texas Hold 'Em. The game of poker has come out of the smoke-filled shadows of the back-room bar to the light of modern, beautiful casinos, featuring professional dealers and gourmet restaurants. The largest card casino in the world, 80,000 square feet and 120 tables, opened in 1984—not in Las Vegas or Atlantic City. The casino is

the Bicycle Club, located in the small city of Bell Gardens, a suburb of Los Angeles. And the only games played are draw poker, low ball, pan, and pai gow.

Casinos offering the full range of gambling games have come to three jurisdictions: Nevada, Puerto Rico and Atlantic City, New Jersey. Even here growth has not been universal. Atlantic City does not allow poker or keno and Nevada does not have a state lottery.

A number of other areas offer casino games on an irregular basis, such as Calgary's blackjack tables for charity and during its July Stampede. Other jurisdictions allow the games if run for charities; New York state, by statute, permits charities to run full-scale casinos. It would be impossible to know how many illegal casino games take place at schools, clubs and meeting halls without police interference, although these games are technically illegal. There is a booming business in the rental of casino equipment. The companies will show a charity how to organize and promote a casino night, and will even train and supply dealers. But they are always careful to disclaim all responsibility, since it is a criminal offense to run a "Las Vegas Night" in virtually every jurisdiction, even if the party only offers prizes for chips won.

Attempts to expand legal, commercial casino gambling have met strong opposition. And yet the attempts continue, in Florida; Detroit; Hot Springs, Arkansas; Pueblo, Colorado and elsewhere.

Professors William Thompson of the University of Nevada, Las Vegas and John Dombrink of the University of California, Irvine have studied the fitful nature in which the third wave of legalized gambling has spread across the country. Their conclusion is that some forms, such as lotteries, conform to a "gravity model:" arguments pro and con are weighed and the public decides whether it wants to legalize or not. Other forms, such as casinos, conform more closely to a "veto model:" one major political actor or serious argument raised against the issue will prevent legalization. Their analysis has great force; in California the Governor and Attorney General came out against the state lottery and the racetrack industry poured in millions of dollars to defeat the initiative; yet, the lottery initiative passed by an overwhelming margin. In other states attempts to legalize casinos have been stopped by the mere threat of opposition from the Governor.

One area of expansion has run into a brick wall: sports betting. Even more than casinos, the drive for legal sports betting has been fought hard by both sides. Only Nevada allows sports betting, yet even the most conservative estimates put the total amount bet on sports, illegally, in the tens of billions of dollars, many times greater than all the state lotteries combined. The pressure to make sports betting legal comes from bettors and legislators in virtually every jurisdiction. The pressure against sports betting comes from the groups that are traditionally opposed to all forms of betting: organized religion and rival gambling businesses, most notably the race tracks. These groups have been unsuccessful in preventing the spread of lotteries, yet they have

been almost universally successful in preventing legal sports betting. The difference lies in the addition of a most powerful ally, the sports organizations themselves.

Professional and college level sports figures are unanimously opposed to allowing bets on their games. The legal questions of whether they can control betting, through restrictions on the use of team names, is secondary to the political weight they carry. Practically no one would attend a horse race if betting were prohibited, so the tracks push for more betting, even OTB, so long as they get a share. More people pay to attend horse races than baseball games. But baseball, basketball and football are surviving without legal betting. And the owners and players do not feel it is necessary, yet, to face the additional regulations and problems legal betting would bring.

TOTAL U.S. GAMING WIN

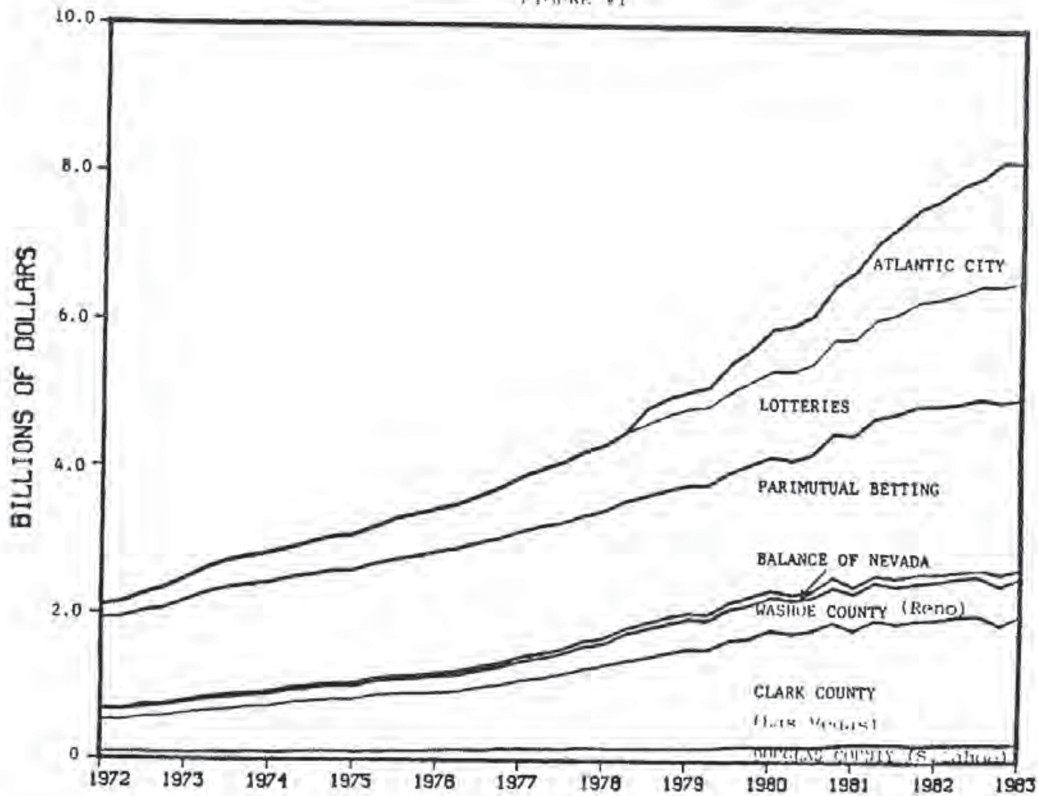


Figure #1 shows the growth of legal gambling in the last decade. This is like a snapshot picture of the third wave of legal gambling. Although we cannot tell what will happen in future years, the wave is obviously growing, and there is nothing to indicate that the wave has reached its crest or will soon slip back. Every single category of commercial gambling shows an increase of income over the beginning of the decade. Even parimutuel betting, the slowest growing category, nearly doubled the amount

won in 1983 compared with 1972. And the totals are something rarely seen in business history, outside of such one-time phenomena as the introduction of the home computer. Total U.S. gaming *win*—that is, the amount actually won by the casinos, tracks and lotteries, not just the amount bet—was slightly over two billion dollars in 1972. Today, the commercial gambling enterprises in this country win over 13.6 billion dollars, per year, a 600 percent increase in 11 years. Another way of looking at this: every year gamblers in America lose almost fourteen billion dollars, legally. The total amount bet is far, far greater. And this does not include a single illegal wager.

Fourteen billion dollars may not sound like a lot when compared with the money thrown away by the defense budget, but for a private business the cash involved in gambling can be phenomenal. Have you ever wondered how much money a casino really makes? The numbers are public records in both Atlantic City and Nevada; however, only in New Jersey are the casinos required to break down their profits by game as well as by year.

In 1984 the average Atlantic City casino had 62 blackjack tables and won $1,971 from each blackjack table, per day. That's $1,971 every day, virtually 365 days a year, from every table, for a total win of $445,887,000 from blackjack alone for the ten casinos. The average daily drop for Atlantic City casino blackjack was $12,237 per table per day. Which means each day players purchased, on average, a total of $12,237 in chips per table and left $1,971 poorer, for a win percentage of 16.1%. The total amount of chips bought at the ten Atlantic City casino's blackjack tables for 1984 was $2,767,957,000. It is not a bad sales item that can generate almost three billion dollars a year in sales and bring a gross profit of 16.1%.

Of course, some casinos do better than others. The Golden Nugget, which has successfully transformed its image from a grind operation to the very finest resort available for high rollers, won an average of $2,741 per table per day. The Trump and Atlantis had wins closer to $1,600 on average. The Nugget's high rollers brought a drop of $16,776; the Atlantis's bus people bought only $10,038 in chips per table per day.

Some games are also more profitable than others. There are less than one-third the number of crap tables in Atlantic City than blackjack tables, but craps brought in almost as much, because the average daily win for a crap table is $5,052 and the daily drop is $35,175; both figures are well over twice as large as the average blackjack table. Roulette brings in a daily win of $2,231 per table; Big Six wins $2,170; Baccarat, with its high minimums and snob appeal, wins $5,765. And then there are the slot machines.

The average nickel slot machine has a "handle" of $757; that's 15,140 pulls of the handle each and every day, or one pull every 4.8 seconds for every 20 hour day the casinos are open. Some players play three coins at a time; but even if every player bet 15 cents each time, every machine on the floor is played over 252 times per hour

on average every second the casino is open. I guess the bus programs are working.

In 1984 there were 384,358 casino bus trips to Atlantic City, bringing in a total of 12.2 million passengers. That is well over 1,000 buses per day that are being loaded and unloaded in a very small area.

The house win percentage on the nickel slots is 14.5% on average; the house makes $107 per day off of every five cent slot machine you see. Imagine having a machine that sits in your business establishment and produces $107 in gross profit every single day. Now imagine you are Resorts International and have 112 of those machines. That's $4,405,000 in gross profit each year.

Of course, other machines do even better. Dime slots win $134 per machine per day; quarter slots win $172; dollar slots win $307; and, the $1.00 Big Bertha machines win $729 per day.

This does not mean that casinos are like having a contract to supply ashtrays for the Department of Defense; sometimes the profits can be nearly as spectacular, but sometimes casinos go bankrupt. In Nevada major hotel-casinos which have filed for bankruptcy reorganization include the Silverbird, Aladdin, Mapes and the Money Tree Casino, the Marina, Riviera, Treasury, Shenandoah and Dunes. Besides the normal costs of running a major enterprise, casino expenses include having a large number of licensed employees, paper work expenses to meet special regulations, unusual problems with debt collection, promotional expenses unheard of in other businesses, and attorneys fees to ensure that all the rest works.

While the spread of commercial gambling has captured the headlines, there has been a virtual, though quiet, revolution in social and charity gambling as well. Thirty-five years ago gambling for money was illegal, period. It did not matter if it was a nickel-ante game of poker played in a neighbor's den or a friendly bet on Monday night football with a co-worker over a beer. Today, virtually every state allows social gambling, so long as no one is running the game for profit. There has been a corresponding revolution in the legality of games run by charities. Church basement bingo has gone from being criminal, though rarely busted, to a multi-million dollar business, legal in all but 5 states. Raffles, a form of lottery, can also be run by established charities in many states.

It is difficult to think of another area of the law where 50 individual states have changed their thinking 180 degrees within such a short time. The laws against marijuana, for example, have been much slower to change, and almost every state that has liberalized its drug laws still makes the possession of marijuana a minor violation.

One of the major problems in estimating the amount of illegal gambling in the country is defining what is illegal. There has been a tremendous decrease in the amount of money bet illegally over the last few decades, simply because many forms of gambling have been made legal. If you want to make the crime rate go down, legalize whatever it is that people are doing so they are no longer committing a crime.

The laws against social gambling were not generally enforced, although they could always be called up and used against the operators of commercial games. The laws could also be used against trouble-makers, or minority groups. Although only 11 percent of the U.S. population is black, blacks accounted for 72.8 percent of gambling arrests in 1974. Maybe gambling by blacks was more visible: the street corner craps game is always going to be busted more often than the home poker game. But maybe the laws were being used to discriminate, so-called "selective enforcement."

Unenforceable laws on social gambling also led to the Prohibition analogy. Everyone has heard of the time alcohol was made illegal in the United States, and the disaster for law enforcement that followed. Speakeasies and bootlegging sprang up almost overnight, in open defiance of the law. There was a general disrespect for the law; the fear was that people would be lead to break other laws as well as the ban on alcohol. What was worse was the realization that since alcohol was illegal the only ones making money on the business were criminals. In fact, organized crime was given a tremendous boost through Prohibition. And when Prohibition was lifted, organized crime turned its sights to other illegal goods and services that people wanted to buy: gambling, prostitution and drugs.

Since people will gamble anyway, the argument went, and we certainly don't want another Prohibition, gambling should be made legal. It is significant that the softening of laws on social gambling occurred at the same time as the legalization of commercial games, such as lotteries and bingo. Once we decide that one form of gambling is morally permissible it is difficult to see why any other form should be restricted. No one would argue that it is proper to bet on a horse at a track, yet a moral sin to bet on that same horse at an OTB parlor.

Some religious groups, opposed to legalized gambling, see this gradual disintegration of the moral barriers as the death of morality. They are unduly pessimistic. Morality, like legal gambling, goes through long historical cycles. For those in favor of gambling, the threat of a religious revival and repression are always present. Puritan morality is not dead, it is just dormant.

Why has legal gambling spread throughout the nation? Why the third wave? Will the third wave end like the first two? Will gambling once again be made illegal?

As every gambler knows, it is impossible to know the future. But we can make some educated guesses, using history as a guide.

The first thing we have to do is separate what people say they are doing from what they are actually doing. The arguments tend to be anecdotal, proponents promise the solution to all of society's problems while opponents tell stories of damnation and decay.

Some of the anecdotes can be quite colorful. To show the importance of keeping at least one form of gambling legal, State Representative John Monks of Oklahoma stated, "In every country the Communists have taken over, the first thing they do is outlaw cockfighting." *Boston Globe*, Nov. 19, 1978.

On the other side, a man who violently opposed casinos described casino gambling as the "most immoral" sort of betting: "They have music, noise, free liquor, chips to help you pretend you're not losing your money. They're the most dangerous form of gambling . . . New York is a great city . . . I don't want to see Mayor Ed Koch turn it into a second-rate gambling town." This from Bernard Rome, former chairman of the New York Off-Track Betting Corporation. *N.Y. Times*, March 16, 1979, at A1, col.5. Thank goodness for the high morality of horse racing.

In every election or debate in a legislature on whether to legalize a form of gambling the same general arguments are heard.

Proponents of legalization argue that anti-gambling laws are unenforceable. People are going to gamble anyway, and giving the police the power to make arrests for crimes everyone is committing leads to "selective enforcement," disrespect for law and order, and possibly much worse. Since people have the money and desire to gamble there are going to be businessmen to meet the market demand. And since the product being sold, gambling, is illegal, by definition the businessmen will be criminals. To stay in business these illegal entrepreneurs must be organized. So by definition, illegal gambling leads to organized crime.

If the police have uncontrolled discretion, if no one is looking over their shoulders while they are walking the beat, there will be endless opportunities for shake-downs, hassling bookies and street gambling games, and for the cops to be bought off by organized crime. The Knapp Commission found widespread corruption throughout the New York City police department; even in pre-inflation 1972 dollars the amount of money a corrupt cop could make was significant. "Participation in organized payoffs—a pad—netted individual officers monthly amounts ranging from $300 to $1500." The Knapp Commission's recommendation: patrol officers were not to enforce the laws against gambling. Obviously, although this would end venality, the illegal operators would soon realize that New York was an open city. Today the city has dozens of illegal casinos and thousands of illegal slot machines, besides bookies and the wide open numbers game.

Two arguments are universally presented by proponents of legalized gambling: 1) organized crime will be hurt; and, 2) the state will be helped financially. These two arguments rest on the proposition that money that would otherwise go into the hands of criminals running illegal games will be diverted into the state coffers through taxation of a voluntary enterprise.

No serious student of gambling today believes that legalized gambling hurts organized crime. A legal game almost never attracts players away from the illegal game. Lottery players, for example, are primarily new gamblers, including a significant portion of people who participate in no other form of gambling. In fact, there is evidence that the introduction of a new legal game increases the number of all bettors, including an increase in the number of people betting illegally.

The main problem with the two fundamental arguments, raising revenue and fighting crime, is that they are incompatible. To fight crime the legal game must be competitive, it must offer the player a better proposition and payout than the illegal operator can. But to do so, especially within the structure of a state bureaucracy, requires foregoing extra profits.

For money to be diverted from the illegal game, the legal game must beat the illegal game at its own game. People play different games for different reasons, the legal game would have to duplicate the characteristics of the illegal game before the player will switch. This appears to have happened in only one or two cases, where the daily legal numbers game has duplicated the illegal numbers game. Legal state lotteries do not necessarily attract the horse bettor; in fact there are indications that the active promoting of a legal lottery *increases* the number of people betting with illegal bookies.

A legal game must do more than simply mimic the illegal game. Taxation is often a problem since only the legal winner can be effectively taxed. Canada avoided this problem by making lottery winnings tax-free. But they are now faced with the new problem of explaining why a worker has to pay taxes on his salary. In fact, only the productive members of society are penalized with taxes.

The illegal operator can offer credit, free liquor, and other inducements, including prostitutes, that the government would find difficult to match. One factor, especially important to big bettors, is secrecy. Here, the illegal operators have a distinct advantage that can hardly be matched by publicly run and open operations. President Reagan's Treasury Department, in attempting to trace drug money, will make the competition even more one-sided when it requires legal casinos to file forms with the IRS on every cash transaction over $10,000.

Legal games are not at a complete disadvantage. In some cases it is a crime not only to run an illegal game but to make illegal bets as well. Illegal operators have been known to resort to blackmail and physical violence, and often don't pay off big winnings; a legal operation is more reliable though perhaps the image is not as romantic. Many players would switch to a legal operation if it were to offer competitive rates and convenience simply because they would rather obey the law than flout it. A legal game can be vigorously promoted; the illegal operator must establish his network of players through carefully established personal contacts. But illegal operators have an advantage in that they are established, have a generally satisfied clientele, are efficient and experienced, and are free from legal accountability and regulation, allowing them to operate in a fluid and convenient manner. With a small fixed overhead the illegal operator can move quickly; I am sure most of the casinos in Atlantic City wished they could have moved to the sunbelt during the winter storms of December 1983.

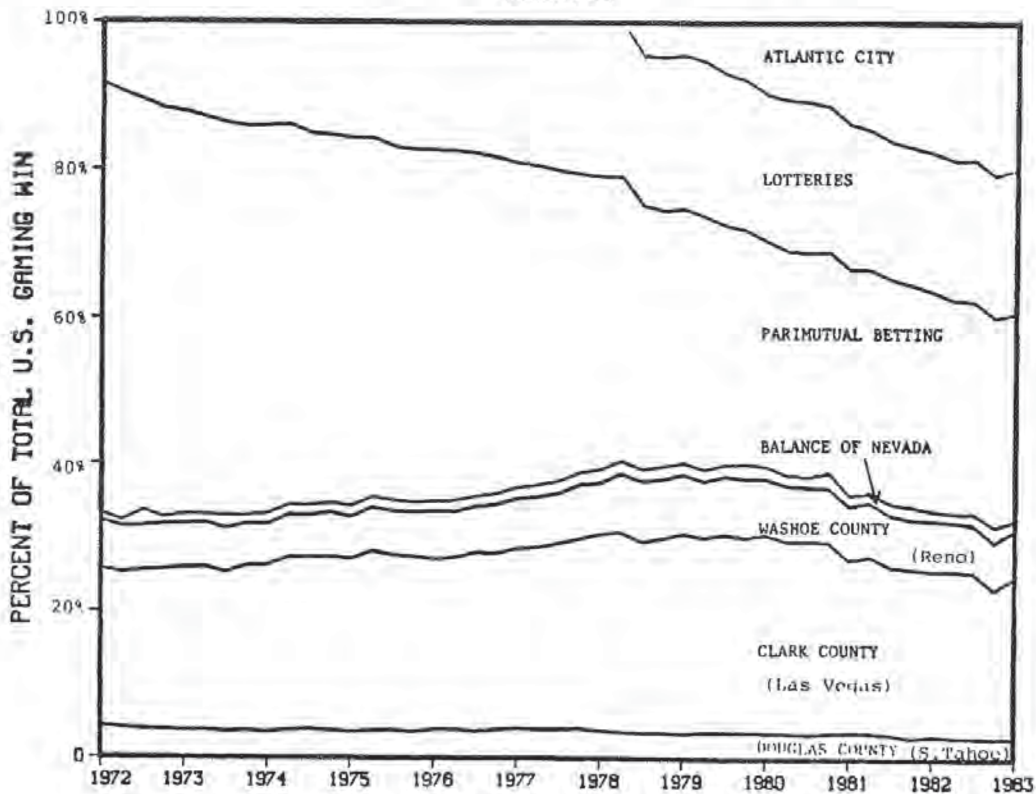
As for the argument about raising money: the dollar amounts have been great in

absolute terms, but, except for Nevada, gambling revenue never amounts to over three percent of a state's budget. Gambling revenue is unpredictable. Viewed as a tax, gambling revenue is voluntary, but unbelievably costly: it costs one and one-half to two cents to collect a regular tax dollar as against 37 cents to collect a net lottery dollar. Gambling is regressive; a one-dollar bet is more significant to a person making $10,000 a year than it is to a person making $50,000 a year; and the poor do bet more than the rich.

There are both direct and indirect costs in setting up a new legal gambling enterprise, like a lottery. A new state bureaucracy is born, along with costly safeguards to prevent theft, corruption and infiltration by organized crime. Since gambling is a regressive tax it hits hardest those parts of society least able to pay. And there will definitely be some individuals, hundreds or thousands, who will fall victim to compulsive gambling, loan sharks, prostitution, and theft. But overall, in pure economic terms, the state probably nets more from the lottery than it pays out for increased police protection, jails and social work; particularly, because most jurisdictions avoid these costs by pretending the problems do not exist.

TOTAL U.S. GAMING WIN

FIGURE #2



One question never asked, and therefore never answered, is where this money is coming from. If the New York state lottery sells one billion dollars in tickets a year, and less than half of that amount is returned in the form of prizes, over half a billion dollars has been taken out of the economy. Some of that money comes from visitors from neighboring states, but since all of New York's neighbors now have their own lotteries there is not much siphoning of outside income. Therefore the money must come out of the pockets of New Yorkers. Is it money that would have been spent on movies, or left in banks, or given to charity? At least one group seems to know the answer; the race tracks and all other forms of parimutuel betting have seen their share of the wagering dollar decrease steadily since the first introduction of legal state lotteries.

Figure #2 shows that the third wave of legal gambling has not swept up all forms of commercial games with equal force. Nevada is a mature market, gambling revenue continues to grow, but only to keep pace with the growth of gambling in general. The two big growth industries are at the top of the chart. Lotteries came from out of almost nowhere to take one out of every three dollars won by legal games. The Atlantic City casinos did come from out of nowhere, prior to 1978 there was no win to report since no casino had yet been built. Now the eleven Atlantic City casinos win almost as much as all of the casinos in Nevada.

Where have the gamblers come from? Figure #1 shows a growth of gambling win from $2 billion to $8 billion in a decade, $14 billion today. This indicates that new players are being introduced to gambling at a scale unmatched in history. However Figure #2 shows the games the new players are playing. The growth of lotteries and Atlantic City has come at the expense of the parimutuel tracks. Perhaps the tracks would not have captured these new gamblers anyway, but the graph shows clearly why the tracks feel it is necessary to fight any proposed expansion of casino gambling or lotteries.

Other arguments are sometimes given for legalization of gambling, though these are usually based on the raising revenue and fighting crime justifications. For example, a legal form of gambling can be tied into a special interest. Casinos in Atlantic City were supposed to revive that dying resort while bringing tax relief for senior citizens. Promised economic benefits include jobs in the construction, gaming and tourist industries, increased property values and a general influx of money from outside the locale. There can be no doubt that Atlantic City drew in hundred of millions of dollars and tens of thousands of jobs. Unfortunately, almost none of this trickled down to rescue Atlantic City itself and there has been virtually no tax relief to date for senior citizens.

Another fairly recent development has been the argument that gambling is merely another form of entertainment and the state should not be imposing the moral view of a minority on everyone. Opposed to this are the arguments raised by the churches

and psychologists that the society owes a duty to people to protect them from themselves.

What is really going on? Why has legal gambling spread despite the consistent controversy? The rise of legalized gambling through the last third of the twentieth century seems almost inevitable. A number of factors are involved, some having little to do with the public discussion and arguments made by either side.

Legalized gambling not only sweeps across the nation in waves, but the waves have a regular pattern. Historically, there has been a consistent, recurring cycle that has twice before resulted in the complete outlawing of gambling. It remains to be seen whether this third wave of legalized gambling will meet the same fate.

The cycle is easy to see. When gambling is illegal there is pressure for legalization, first of one game and then, gradually, of all forms. Gambling becomes legal, widespread and commercialized; everyone seems to be playing and the amounts of money involved are staggering. Soon there are devastating public scandals and the populace cries for reform. Crackdowns are followed by more scandal until the majority revolts and throws the incumbents out of office, and in the process attempts to outlaw gambling forever. Gambling is now illegal and the process starts all over again.

When all forms of gambling are outlawed, a significant proportion of the population continues to gamble illegally. The gambling laws are notoriously difficult to enforce. Gambling arrests are never considered "sexy" by the police, and the general population does not want these laws enforced, if it means taking resources away from more serious crimes. The result is disrespect for the law and corruption. The response by the public is often a call for reform, for something to be done about official involvement in these areas of moral ambiguity, for legalization.

Once one form of gambling has been legalized, the moral arguments against all of the other forms begin to drop away. People see hypocrisy in allowing some forms of betting but making almost identical forms illegal. People also see the state legalization of one game as the moral approval of gambling in all forms. Even the legalization of a game by a neighboring state can start the decline of the moral barriers against legalization. The next steps are a series of extensions of legal gambling, and the active promotion of those games that are already legal.

Once the idea of legalized gambling has been accepted, even if only in an isolated area, discussion can be directed away from morality and toward cost/benefit analyses of various other games that might be put into place. It becomes increasingly difficult for the police and prosecutors to enforce those gambling laws that are still on the books. There are increasing cries for reform and for a relaxation of the laws against all forms of gambling.

There are other forces pushing for legalization. Many cities and states feel themselves under severe economic pressure. Gambling revenue appears to be both

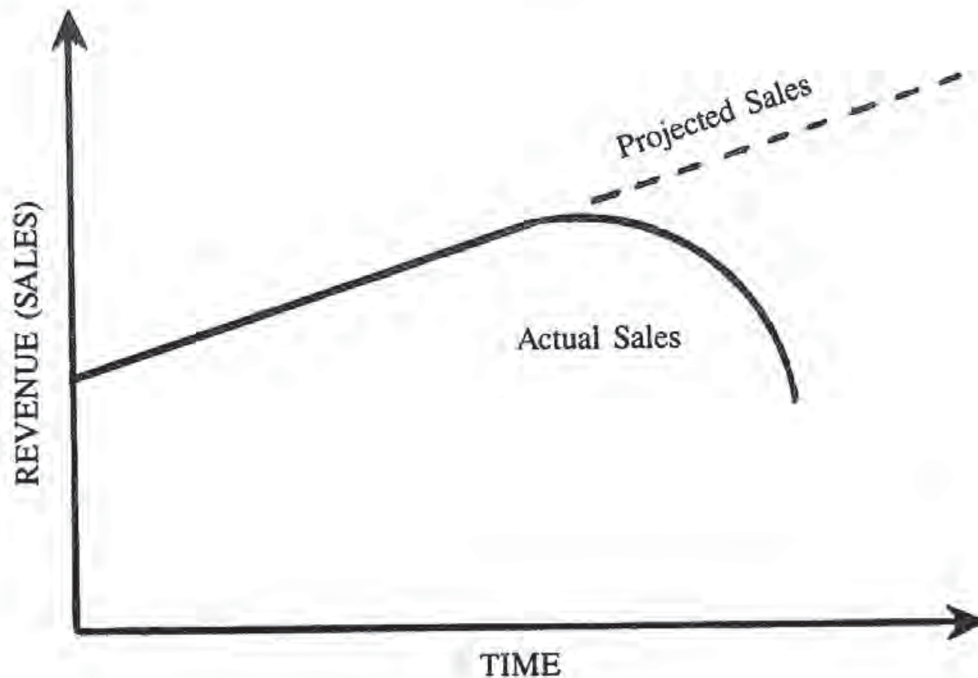
painless and voluntary, especially when compared with imposing or raising a local income tax or sales tax.

A related factor is the siphoning effect of a neighboring state's legal game—the domino effect. When New Hampshire was the only legal state lottery in the country it sold 80% of its lottery tickets to residents of Massachusetts, New York and Connecticut. The residents of New Hampshire were getting a free ride. It is not surprising that New York became the second state to put in a state lottery; it saw too many of its citizens spending their disposable income away from home.

The first state to offer a new game attracts players and their money from all neighboring states. The gameless states perceive a drain on the disposable income of their residents, a competitive disadvantage in the drive to capture foreign dollars, and a corresponding increase in jobs and revenue for the state that has the legal game.

A cycle of escalation and retaliation begins—what you might call legal gambling wars. Once all of the neighboring states have instituted the legal game, the disparity between states has been wiped out, and the first state to institute a new game will again have an advantage over its neighbors, at least until all states again have the

FIGURE #3
THE "J" CURVE



new game. Obviously, if every state has a lottery, the first state to introduce off-track betting, or jai alai, would once again gain an advantage over its neighbors, and maybe grab some of the neighbor's expendable income. This domino effect can be seen most clearly on the East Coast, where states are competing for the gambler's dollar first with on-track betting, then with state lotteries, and now breaking into the new fields of OTB, jai alai, dog racing and finally casinos.

Where will the legal gambling war end? Atlantic City has now become the number one tourist attraction in the nation, with more visitors each year than DisneyWorld or any other spot in America. Neighboring resort areas, and those that perceive themselves as being in competition, such as Miami, are seriously considering putting in casinos to win back some of their lost tourist trade. Atlantic City has been only a qualified success and its neighbors have not been anxious to take the additional problems of casinos along with their demonstrated power to raise money.

Another economic reason for the spread of legalized gambling comes from the characteristic expansion and then contraction of state gambling revenue, and the resulting state dependence on this source of funds. The typical legalized gambling game shows a period of slow growth in revenue for the state followed by a rapid decline: over time the revenue curve resembles a letter "J" on its side.

The "J curve" shape of the revenue brought in by legalized gambling is the result of initial interest in the new game followed by a satiated market and a rapid drop in player interest. Before a new game is introduced there is a flurry of interest in the press and among potential players. Once the game becomes a reality more and more people find out about it and play it, for a while. What no one seems to notice is that after the first few months or years of success, every game begins to take in less and less money and to require more and more promotions.

It appears that a state can expect a new game to bring in gradually more money for about the first eighteen months before there is a sudden dropoff in revenue. This time length is sufficient for the state to enjoy the fruits of the new game, to spend the money raised and to prepare the next year's state budget, with the expectation that an equal amount or more of gaming revenue will appear. Only it never appears. Gambling games, including lotteries, are not bottomless wells from which the state can dip forever without worry. People try the games for a while then either grow bored or too wise to continue to bet. Even neighboring states contain only limited numbers of potential players.

When the sudden drop in revenue hits, the state is forced to take counter measures, to begin promoting the game and to create new variations to increase interest. Interested parties push for more gambling. These include the bureaucracy that runs the program; recipients, such as the elderly, who were promised the gambling-raised revenue; and incumbent politicians who would be forced to turn to other sources

if this funding disappeared. Soon the state finds itself in the gambling business, actively promoting the game and trying to attract new players.

The result is something unique in American culture. State lottery tickets are the only consumer products that are widely advertised and backed by the prestige and integrity of state government. You do not see the state advertising tooth paste, or even for people to brush their teeth. But you do see the state actively encouraging its citizens to gamble.

The new Colorado Lottery is a case study in the effects of the "J curve." During its first year and a half the lottery sold over $275 million in tickets. Sales for the lottery's fiscal year 1983-1984 hit $120 million; yet, sales for the next fiscal year dropped off, and estimates for 1984-1985 fell 25% to $92.5 million. As Colorado Lottery Director Owen Hickey described it, "At first, Coloradoans bought tickets at an incredible pace, but the excitement over the game has leveled off."

The Colorado Lottery Commission was faced with the same problem other legal games have faced: declining revenues after a short, successful run. The Commission sought funding from the state legislature to introduce a new game to recapture the lost revenue: lotto. In a development that is most unusual for legalized gambling, the Colorado Legislature turned them down.

The Lottery Commission was now in a bind. The game was already being promoted to the hilt yet sales were falling dramatically and relentlessly. The legislators' veto of a lotto game seemed to toll the death knell for the Colorado Lottery, by law the Commissioners were limited to instant games.

In a move of great ingenuity, possibly born out of desperation, the Commission came up with a new twist for its dying game: "SuperInstant." The game, created by Scientific Games, Inc., the company that supplied the state with its lottery tickets, combined a grand prize with the traditional rub-off smaller instant prizes. A player now has the chance to win $2 to $50,000 instantly, and winners of $500 are entered into a second drawing that is televised weekly. These finalists spin a wheel for $1,000 to $1 million, or more.

The Colorado Lottery Commission has solved its "J curve" problem. Of course, the solution destroys the concept of what is an instant winner and may possibly violate the state law. But sales have picked up dramatically; at least for a while.

What does all this mean for you? If you are a lawmaker or administrator, involved in setting up a legal game, you must know what you are getting into. Revenue will be almost impossible to predict, although it is very likely that whatever you see in the first 18 months will not continue without aggressive advertising and the introduction of new games. The pressure to loosen the rules and expand the forms of gambling that are legal will be enormous, while the forces for stricter controls or cutbacks will almost completely disappear. The money involved is so great, from the 5% that goes to the ticketsellers, to the millions in tax dollars raised for the elderly or schools,

that the slightest downturn in revenue will lead to lobbying and political pressure far beyond any you have ever seen on any issue in your career in government. Check the contribution records in any statehouse in the country and you will see that among the biggest contributors are the legal gambling interests, because they have to be. They are the only legal enterprises that need the constant endorsement of government and that can be outlawed with a flick of the pen.

If you are on the business side of the tables, either running a casino, or supplying lottery tickets, or marketing video machines, realize that the market is definitely limited, and probably much more limited than the first sales figures would indicate. When Resorts International opened the first casino in Atlantic City players were standing in line to get to $25 minimum crap tables. By the time the eighth casino opened in Atlantic City the market was glutted, and the "J curve" effect started to hit. In 1982 the New Jersey Casino Control Commission declared the experiment in casino gaming "a financial emergency."

It is almost a sure thing to invest one hundred million dollars when you are the monopoly supplier for the entire East Coast of a product that almost everybody wants. To invest $300 million when there are already eleven casinos divvying up a shrinking market makes no sense at all.

What does all this mean for the player? First, the tide is going to continue for a long time before it begins to withdraw. States will be trying various forms of legalized gambling as a way of gaining easy money, and will be trapped by the downturn in revenues into heavy promotions and experiments with new games. Current restrictions and regulations will be relaxed, though often in the house's favor. Now is the time to lobby your state legislature for a local game, and to push for expansion of existing operations, including increased hours, lower prices, easier availability.

Where the games are already in operation look for more bargains: they are feeling the competition and it should be easier to get comps, credit, etc. Be on the look out for hard luck stories from gambling operators. The casinos in Atlantic City convinced the New Jersey Casino Control Commission to change the rules on blackjack, eliminating surrender, on the grounds that expert players were ruining their profit margins.

Also keep your eyes open for investment opportunities. Del E. Webb Corp., *Penthouse* magazine publisher Bob Guccione, and the Golden Nugget all took out options on hotels in Florida's Gold Coast prior to a vote on legalizing casino gambling. If the vote had been successful these companies and their shareholders could have made large windfall profits in the short run. Conversely, the casinos that are about to open in Atlantic City are getting in very late, and are going to add even more unwanted competition to the casinos already there. There are only so many bus-people *and* high rollers available, and most of those are already gambling to the max. A little research with a good investment service like Value Line or Standard and Poors

can tell you which company owns what and how to take advantage of unusual profits or losses. Ask a stockbroker and follow developments in *Gambling Times* Magazine and the other sources listed in the Resources section of this book.

The same factors that are working for expansion of legalized gambling in the United States are present throughout the world, only complicated by international politics. For example, Macau is a Portuguese colony, a remnant of a faded empire, occupying the small isolated tip of a rocky peninsula jutting out of mainland China. Westerners rarely visit. It has winding streets and the ruins of Iberian architecture and hundreds of thousands of poverty-ridden Chinese, who escaped during the Communist takeover of the mainland, all within six square miles surrounded on three sides by the ocean and on the fourth by the most populous country on Earth. It also has legalized gambling, and even in the middle of a weekday afternoon the casinos are teeming with players, often four and five deep around the tables. It is an hour's hydroplane ride from Hong Kong, which does not have casinos.

On a trip to Macau I happened to be sitting next to a Hong Kong businessman and struck up a conversation. The brooding presence of the Peoples Republic of China, a billion people with the border only three miles away from the casino, creates a tension in the air that is almost palpable. I asked my companion why the P.R.C. allowed Macau to exist.

"For the foreign currency, my friend," he answered. "Macau gets almost all of its food and water from the P.R.C. and pays for it with hard currency. And China needs ports for outside trade."

"And what does Hong Kong get from Macau?" I asked.

"Gambling," he answered. "We get legal casinos without having to regulate them."

I wondered how long it would be before some Hong Kong entrepreneur with sufficient political clout came along to cut off this flow of Hong Kong dollars to Macau. Complicating the issue is the political power of the Royal Hong Kong Jockey Club; with a near monopoly on legal gambling, both on- and off-track, the Jockey Club has an overall turnover of $2 billion. Considering Hong Kong is smaller than Brooklyn, and the Jockey Club has but two tracks, the $2 billion bet each year is extraordinary; all of the tracks in the United States total only $10.3 billion a year. And now the treaty has been signed, and Hong Kong will become a part of the P.R.C. in 1997, though the Communist government has promised not to interfere in the free-wheeling capitalist Hong Kong life style for an additional 50 years. Will the Communist government in Beijing allow gambling to continue, or even grow, in its newly acquired territory? The Royal Hong Kong Jockey Club has announced that it has received assurances, informally, that racing will continue after 1997.

Internationally, the biggest growth is in the development of casino resorts in such areas as Australia, Spain and the Caribbean, although slot machines are blossoming everywhere, including behind the Iron Curtain. The legal gambling tide has swept

the seas: there are a growing number of gambling ships plying international waters and one airline, Singapore Airlines, has even put slot machines aboard a plane. International carriers and companies set to profit from gambling trade between nations will profit; U.S. carriers on the other hand will not: a federal law prohibits gambling on U.S. flagships.

How can a player take advantage of the international gambling boom? Again, there are investment opportunities for the knowledgeable. And competition is increasing here as well: it is easier to obtain comps and relaxed rules; free trips to Spain, for example. At the very least, there are more choices and interesting places for a gambling vacation.

The forces for more and more legalization seem unstoppable. Yet, twice in American history, legal gambling came crashing down. What happened? Both times scandals and corruption were rampant. Legislators were bribed, as were judges, police and other public officials. Even worse, the officials who were supposed to be controlling the criminals were seen instead as part of the criminal organizations.

Corruption of public officials is not new, but voters like to see corruption kept behind closed doors and at an acceptable level, so they can pretend it does not exist. The scandals associated with the first two waves became public indeed; at one point the President of the United States addressed the United States Congress with a demand that they do something about the Louisiana Lottery scandal.

There was a second factor, more important than the corruption of public officials, that may have been legal gambling's undoing in the 19th century. The games became viewed not only as corrupting, but also as fixed. Cheating was the one sin that no gambler would forgive. Cheating ranged from fixed drawings of lottery tickets and rigged decks of cards to those entrepreneurial lottery operators who set up shop, flooded the newspapers with ads, collected their envelopes filled with cash for lottery tickets and cut out, without bothering to have a drawing at all. Scandals on this level led to the complete prohibition of most forms of gambling by the beginning of the twentieth century.

Will the third wave come crashing down? Legalizing gambling in the twentieth century has so far been a one-way street. Other than a few short-lived experiments with slot machines, no state in 50 years has declared a gambling game illegal once it has been made legal. And no state seems able to resist the pressure to promote heavily those games that it has come to rely upon for revenue, or to create new games once the revenue starts to drop.

All of the factors leading to the expansion of gambling found in the first and second waves are present today. Whether the cycle of outlawed games, pressure for legalization, widespread legal gambling, scandal, and re-criminalization will be followed depends on the one major difference between the legal games of the 1980s

and those of 1880s. That difference is the degree of government involvement in legal gambling.

You will often hear people say that things are different today, these are state lotteries, not private lotteries like they had a hundred years ago. That statement is not completely accurate. Many of the lotteries of the 18th and 19th century were state lotteries; even the federal government ran lotteries. And the distinction between state and private ownership does not work for casinos, bingo games and racetracks.

If there is any difference it is in the level of government regulation and sophistication today. There have been less than a half-dozen major scandals involving state lotteries in the last 20 years, fewer than the number of scandals related to the regulation of atomic plants. And none of the scandals touched the regulators; the state is seen as honest. Casinos have not been so fortunate, but casinos are seen as institutions as large and as powerful and as regulated as banks. Even banks have embezzlements, but the casino, like the bank would never cheat the customer; the government sees to that. If that continues to be the prevailing perception, legal gambling, or at least those forms that are heavily regulated, will continue to flourish. This is one case where heavy regulation may save an industry from eventual disaster.

It is hard to be entirely optimistic about the future of legal gambling. There is simply too much money at stake for there not to be major scandals. Eleven casinos in Atlantic City take in almost $2 billion each year, in profit, much of it in cash. New York and Pennsylvania state lotteries each sell over $1 billion in tickets each year, most in small bills. Imagine any other business that takes in hundreds of millions of dollars in cash each year, where the only product being sold is the cash itself. If a crook could divert only one percent of the lottery ticket sales into his own pocket, he would have $10 million in untraceable cash. If the crook could do that by bribing 10 officials with $50,000 each he would still net $9,500,000 in tax-free profit. And a $50,000 bribe is a substantial sum for a state civil servant.

The pressure for relaxed enforcement of the laws and regulations has already produced some embarrassing results. Resorts International was given a temporary permit to open the first casino in Atlantic City. When the time came to decide whether Resorts should be given a permanent license, the Attorney General of New Jersey recommended denying the company a permanent license. The Attorney General's investigation had discovered the following facts: in establishing and running a casino in the Bahamas Resorts had dealings with a business associate who had a record of association with criminal individuals, Resorts continued its relationship with an individual of "unsuitable reputation, character and nature" after being ordered by the Bahamian government to sever the relationship, Resorts "maintained an unrecorded cash fund from which it rendered payments to Bahamian public officials, and the company was currently employing an individual who has admitted in sworn testimony an attempt to bribe a judge and supplying paid female companions to Bahamian public

officials. To compound the problem, the company had not proven itself competent to run a casino in Atlantic City; Resorts' incomplete accounting system had allowed tens of thousands of dollars in slot machine change to disappear.

Despite the Attorney General's recommendations, Resorts International was given a permanent license. The political pressure, including the hundreds of millions of dollars pouring into Atlantic City, was too great for the Casino Control Commissioners to admit they had made a mistake.

Perhaps the fatal scandals will never come. Parimutuel betting and race tracks have been around for fifty years, despite repeated horse drugging and other public improprieties. Or perhaps we are simply still in a rising wave, and the crash won't come for another 40 or 50 years. It is important for anyone interested in legal gambling to take a broad view of what is happening in this country, to understand how and why we got to where we are today, and to try and predict what will happen tomorrow. Self preservation, at the very least, dictates that we not simply believe that everything that we see around us will remain the same throughout our lives.

2

Where Does the Law Come From

Why is draw poker legal in Bell Gardens and Gardena, small suburbs virtually surrounded by the city of Los Angeles? Why don't you see any poker clubs across the street in L.A. itself? And why draw poker? Why not stud poker or hold 'em?

Why is it so difficult to get a state lottery started? Sometimes all it takes is a vote of the state legislature; other times you have to get two-thirds approval of all the voters at a general election. And even if your state has a lottery you won't see any video lottery machines, unless you live in Illinois or Nebraska. Who decides what is legal and what is not?

It probably would not surprise you to read that gambling debts are collectible in New Jersey; after all, the courts are going to help the casinos, right? But gambling debts were not collectible in Nevada until very recently; a casino who tried to sue a player on a bounced check was out of luck. And even today a player who tries to sue a casino in Nevada will find himself kicked out of court.

If you live in New York you had better make good on your markers, but if you live in Florida you can laugh when the casino comes calling. Who makes up all these laws anyway?

Who does make the law? The answer you hear in your civics books is you do; that is, the voters choose their representatives who pass legislation that becomes the law. That answer is partially correct, but it is at least as wrong as it is right. There is a lot more to the law than a bunch of politicians voting on bills.

At the very least there are a number of important divisions of power you must know about. There is a hierarchy in the law: federal, state and local. Within each level of the hierarchy there are additional divisions, such as the limitations set by the federal or state constitutions on the power of legislators to make laws. When there is a direct dispute between one set of laws and another the rules of the hierarchy determine who wins: state laws must give way to federal laws, including the most powerful of the federal laws, the United States Constitution.

There are also those branches of government you learned about in school: the legislative, executive and judicial. These, you were told, make, enforce and interpret the law. What you were not told is that there are groups that *really* make the law. The most powerful of these are the administrative bodies, such as the Nevada Gaming Commission and the Internal Revenue Service. In addition, the law is made informally all the time, by prosecutors refusing to press cases or by judges and even court clerks letting people know where they stand on certain issues.

In theory, and to a great extent in practice, the formal systems of lawmaking function as they were meant to when they were first created. To understand what that means you first must learn to think like a lawyer. In this case it means thinking like a colonial patriot of 1776, putting aside the last 200 years of history as irrelevant.

The American Revolution, you remember, was fought for independence, and it is sometimes difficult to realize in these days of the supremely powerful presidency that independence meant just that—independence. The states were almost independent countries; the war with England was not fought to create a new, strong central government.

It has only been in this century that the federal government has grown in power to completely eclipse the states. Television has helped change our way of thinking about government. Half-hour news shows almost always carry stories about the President, and sometimes about Congress, or the United States Supreme Court. There simply is no time to cover what 50 governors, 50 state legislatures, and thousands of local judges are doing.

The 13 original states gave up some, but by no means all, of their power to the new federal government. The federal government is thus a government of limited power: if the United States Constitution does not specifically give the federal government the power to do something, then the United States Congress, the U.S. Supreme Court and all the other federal courts, and the President simply do not have that power.

Most crimes, for example, including most anti-gambling laws, are still solely the responsibility of the various states; a lawyer would say the federal government has no jurisdiction over the offense. To get federal jurisdiction the government must show that some power given it by the U.S. Constitution is involved, such as the power to regulate interstate commerce, the federal taxes, the United States Treasury, or the use of the United States mail.

In the next chapter I will discuss every federal law dealing with gambling. What is important to know now is that there are relatively few such laws. Historically, the federal government has only become involved in the regulation of gambling when it appeared that the state or local police were not doing their jobs, particularly, when it looked like a large scale gambling operation had bought off all of the local cops. Sometimes it even seemed as if an entire state had been bought off. The wide-open

illegal slot machines in Louisiana under Huey P. Long were one part of the Governor's close association with New York racketeer, Frank Costello.

A quick look at the federal laws shows that Congress is mainly concerned with interstate, organized racketeering. Of course, there are also laws about federal taxes, and gambling on Indian land, but for the most part the federal government has stayed out of the civil (that is the non-criminal) side of gambling. The regulation and control of legal and illegal gambling is one of the few areas left in American life that is left up to the states to control.

States have jurisdictional limits just like the federal government; they cannot exceed the power given them as independent members of our federation of states. A state cannot declare war on Mexico, for example. The answer is not quite as clear where a state passes a law that appears to be valid on its face, but which, in practice, greatly interferes with the power given the federal government. Most states which do not have lotteries prohibit the sale of lottery tickets within their state boundaries. Can a state prohibit the sale of a neighboring state's legal lottery tickets? Probably not, because it would infringe on the power given the federal Congress to regulate interstate commerce.

But states can experiment, within limits. In fact, the United States Supreme Court has expressly stated that states *should* experiment. If New Jersey wants to try legalizing casinos as a way of revitalizing a dying resort community, so much the better. If it works then other states can try it; if it fails, it will serve as a lesson to be learned. In no event is it a problem for the federal government. So long as things stay relatively under control the feds will not, in fact cannot, become involved.

Who makes the laws for the states? Like on the federal level, the basic document is a constitution, spelling out the procedures and limitations on lawmaking. The normal procedure we all know: The state legislature is to be elected by the voters of the state; the legislature passes bills which become law with the Governor's signature, or by overriding his veto.

One of the interesting twists in the study of gambling law is that the state constitutions often severely limit the power of the legislature to make gambling legal. Antigambling feelings were running so high in the 19th century that the people of that era put into their constitutions language meant to tie down their state legislators for all time.

One indication of the futility of such attempts can be seen by the state of Nevada. The Nevada Constitution forbids the Nevada Legislature from authorizing any form of lottery. And to this day the Nevada Legislature has never allowed a lottery in that state. Of course, they have allowed keno, bingo, slot machines, and every form of casino game, but no lottery.

The 19th century drafters of the state constitutions also could not prevent times and the opinions of voters from changing. Where the constitution prohibits gambling it has become necessary for promoters to amend the constitution. The backers of

the state lottery in California spent over $2 million gathering hundreds of thousands of signatures and promoting an initiative that appeared on the ballot during the 1984 presidential election. Fifty-seven percent of the voters marked their ballots in favor of changing the state Constitution. Pursuant to the election, the California Constitution now reads that the state Legislature shall never authorize a lottery, except for a state lottery.

In some other states it was not necessary to call for a vote of the general public to install a state lottery, because the lottery was not prohibited by the state constitution. In most cases, if the state constitution does not prohibit something, the legislature can make that activity legal simply by a majority vote in each house, and the signature of the governor. Nevada put in casino gambling in 1931 by a simple majority vote of its Legislature; New Jersey, on the other hand, was forced to call for a vote of the general public to amend its Constitution to put in casinos in Atlantic City.

The colonial patriots were concerned about the possibility of the Executive branch (then the King and now the President or Governor) and the Legislative Branch (then Parliament and now Congress or the state legislatures) grabbing too much power. A written constitution was one safeguard our founding fathers put into place. We take the concept of constitutional limits for granted today, but the idea was a radical experiment in the 18th century. The idea of having a constitution is an American invention, and even today England does not have a formal, written constitution.

But the founding fathers knew that a constitution could be ignored, or twisted, especially in troubled times, when it was most needed. Although there is some dispute as to whether the drafters of the U.S. Constitution meant for the courts to have all the power they exercise today, the third branch of government, the judiciary, was clearly intended to be a balancing force constraining the legislative and executive branches.

Shortly after the American Revolution the U.S. Supreme Court announced that it had the power to declare the actions of the other two branches void when they violated the Constitution. That power has grown over the centuries until it is universally recognized that the courts are the final interpreters and protectors of all of our constitutional rights.

Every American is subject to two court systems, state and federal, and they often overlap. There are many instances of a federal court, including the U.S. Supreme Court, declaring a state law or state administrative action illegal under the U.S. Constitution. And it is even more common for a state court to declare a state action void under the federal Constitution. Practically every criminal case involves a claim that the defendant, arrested by state police, was deprived of his federal constitutional rights through an improper search and seizure, or improperly obtained confession, etc.

Similar arguments are often made that some action violates the state constitution. Although most state constitutions duplicate the rights given under the U.S. Constitu-

tion, some, particularly in Western states, give additional rights to individuals. In recent years state supreme courts have found laws unconstitutional under their state constitutions, thus depriving the loser, usually the state prosecutor, from appealing to the U.S. Supreme Court. There is nothing to appeal, because the U.S. Supreme Court cannot tell the state courts how to interpret their state constitutions.

My personal favorite is the fine distinction drawn between California and the U.S. Constitution on the issue of punishment, such as the death penalty. The U.S. Constitution protects all Americans against "cruel *and* unusual punishment." The California Constitution, in addition, protects Californians against "cruel *or* unusual punishment." I think the difference was simply a typo, slipped in accidentally in 1848. However, in practice the California Supreme Court has found the difference to be highly significant. The federal Constitution prohibits only those punishments that are both cruel *and* unusual; if the punishment is simply cruel, such as the death penalty, it is allowed. The California Constitution adds an extra protection and prohibits those punishments that are merely cruel, without being unusual, or are unusual, without being cruel. It is interpretations of the law such as these that make lawyers so well loved.

Although it is the constitutional cases that make the news, the courts are normally concerned with interpreting ordinary statutes, regulations, and the common law. Statutes are laws enacted by the duly elected legislators. Statutory language can be vague and confusing, because statutes are the result of political compromises, the English language is imprecise, or the legislators simply did not think about all the possible ramifications of their new law. Courts are often called upon to decide the legislative intent, even when the legislature never thought of the problem. For example, did the Montana state Legislature intend to make video poker machines legal when it passed a statute making poker legal? The Montana Supreme Court split on this question, the majority finding that the machines are not "poker", within the meaning of the statute.

Regulations are a little more complicated. Those are rules created by an administrative body that has been given the power to make those rules by the duly elected legislators. The courts are required to see that the administrators acted within the power delegated to them by a statute; and further, that they acted within the rules the administrators themselves have set up for holding hearings and making further rules.

The common law is what most lawyers think of when you mention "the law," because that is what they spent most of their time studying in law school. Basically, the common law is the "unwritten" law, passed down and refined through court decisions. Fortunately, those court decisions are written down, so that lawyers and judges can find out what previous courts have said on any issue, if it happened to come up in the past.

Much of the law of gambling is common law. Since this is judge-made law, the results will often differ from state to state and court to court. The courts of New York felt that gambling was not against the public policy of that state; therefore, an out-of-state casino could sue a New Yorker in state court and collect on the gambler's bum checks. A court in Florida, faced with the identical question, looked at the horse racing and jai alai in that state and decided that these were contests staged for the entertainment of tourists; the parimutuel betting that went on was merely incidental. The Florida judge declared casino gambling against the public policy of that state and refused to allow a licensed Puerto Rican casino to collect. There are limits on how far-out a judge can go in interpreting the common law, but every lawsuit, and every appeal, entails a great deal of time, expense and aggravation.

There are two more levels of law, besides federal and state, that must be dealt with in detail if you are to understand the law of gambling in the United States. Federal law is obviously important, like a great gray cloud hanging over the entire country. But so far the cloud has not rained down too heavily on the legal gambling business. State law is almost everything: if a state constitution or statute passed by the state legislature says lotteries are illegal there are no lotteries in that state. On the other hand, if the state law says there can be casinos, or off-track betting, or charity bingo, you can be sure that some entrepreneurs will quickly open those gambling games to the paying public.

The third area of great importance to legal gambling is local government. Local government tends to be small, disorganized and generally a pain in the neck for legal operators, with a myriad of licenses, taxes, and rules, none of which seem to have been clearly written, let alone easily found. Local governments, cities and counties, are of prime importance in three ways:

1) Charities are usually locally regulated. Just as the federal government has left gambling to state control, states have tended to leave charities to local control. So charities have to deal on an intimate basis with city councils and county supervisors, and their local regulatory agencies, to get all the necessary licenses to run a legal bingo game. Since local governments officials often serve on a part-time basis, holding down full-time jobs and meeting once a month, it is often up to a charity to write up the rules they want other charity gambling games to live by.

2) Local option games. Sometimes the state allows the counties or cities to decide what should be legal. Poker in California is the best example. State law allows the playing of draw poker for money. However, each county has the option of making the game illegal. San Francisco County bans card rooms. Los Angeles County allows them; however, a city can also make the game illegal. So, although L.A. County allows poker clubs, the major cities of Long Beach and Los Angeles do not. The independent cities of Bell Gardens and Gardena allow poker. A legal poker club in these cities must keep in close touch with the city council and city attorney, to know

what is legal and what is not, since the cities have exercised their local option.

3) Local roadblocks. Normally a city or county cannot prevent a legal business, such as a licensed casino, from opening. But they sure can make it tough. Zoning is a favorite way to squeeze the operators for everything the local government can get. I am not implying illegal extortion, although local governments have been more susceptible to bribery scandals than state and federal officials. I am referring instead to the legitimate desire of local government to obtain jobs for local citizens, and adequate parking, and green parks, etc. This also creates jobs for local lawyers, since they are the only ones who can deal with the unbelievable load of paperwork and regulations required by local bureaucrats.

The last level of government is probably the most important, at least on a day to day basis, and yet is the least known. This is the level of the regulators.

It is impossible to underestimate the power of the regulators on legal gambling. The Supreme Court of Nevada went so far as to make the following statement, unprecedented in American law:

> "We view gambling as a matter reserved to the states within the meaning of the Tenth Amendment to the United States Constitution. Within this context we find no room for federally protected constitutional rights. This distinctively state problem is to be governed, controlled and regulated by the state legislature and, to the extent the legislature decrees, by the Nevada Constitution. It is apparent that if we were to recognize federal protections of this wholly privileged state enterprise, necessary state control would be substantially diminished and federal intrusion invited." *State v. Rosenthal*, 93 Nev. 36, 559 P.2d 830, 836 (1977); appeal dismissed, 434 U.S. 803 (1977).

As a lawyer and professor of law I find the statement simply amazing. The highest court of a state is declaring that when you enter the world of legal gambling you give up all of your federal civil rights. All law abandon, ye who enter here! Can you imagine any other legal business being exempt from the Bill of Rights? (Other courts, including a federal court sitting in Nevada and the New Jersey Supreme Court, have said state's rights do not go this far.)

What is even more amazing is that the United States Supreme Court refused to hear the appeal, despite the fact that the losing side had hired the former dean of Harvard Law School, Erwin N. Griswold, to argue the case. But, as I have said, the federal government, including the top federal Court, has pretty much left the states to do what they wish with legal gambling.

No industry in America is as heavily regulated as legalized gambling, including atomic power plants. However, regulation is by no means uniform. Startling differences

arise between regions of the country, or even between various games played within a single state.

Why regulate at all? The standard reasons given are to ensure competency of the operators while keeping organized crime out. Perhaps more important are the twin issues of money and image. If the gambling operators are stealing they are cheating the state out of its tax revenue. And legal gambling is always subject to attack from outsiders; like alcohol, the industry has to be extremely careful about its reputation for causing harm or it can find itself easily outlawed again.

When a state decides to make a gambling game legal it has a number of options as to the type of controls available. The first option is no control at all. This has been the favorite response for charity games and social gambling. The legislature votes to legalize bingo, for example, to prevent those embarrassing raids on church basement games. It is not thought necessary to regulate the games, other than to ensure that it is actually a charity that is getting the profits. The result usually is widespread, commercial gambling that does not attract a lot of attention, until there are a few scandals and cutthroat competition develops between charities. Then the government begins to think about regulations.

The government has essentially two ways to go: state ownership or private control. The state government owns the state lottery, even when it contracts with a private company to set up the system. Similarly, New York decided to go with a quasi-public corporation when it set up the Off Track Betting system. At the very least state ownership is designed to make it easier to control what goes on with the game; hidden ownership by organized crime is impossible (although cheating is not). And since the legal game is a monopoly the government takes the maximum possible out of each game.

So why not state ownership of casinos? Although there has been some talk about it (former Governor Carey proposed state owned casinos for New York) the trend is definitely away from direct government ownership. The problems are both practical and political. State bureaucracies have not proven themselves to be more competent than private industry at running businesses, including gambling. New York's OTB and a number of state lotteries have floundered almost into bankruptcy, despite having a monopoly. Bureaucracies take on a life of their own, and seek constantly to expand their power. This urge to grow runs smack into the realities of the marketplace, including the "J curve" effect I described in the last chapter, and expansion often comes at the very time revenue takes a nosedive.

The urge to grow may create image problems for incumbent office holders. The general public understands that legal gambling must be kept under strict controls, to prevent corruption and cheating. Without that feeling in the general population it would be difficult to justify the existence of a state lottery, the only part of state government whose sole purpose is to raise money. State owned liquor stores were

not created to raise money, but rather to control and limit the vice. If raising money is so important why doesn't the state own hotels and clothing stores? If the difference is that gambling is a vice that people will do anyway, why doesn't the state own houses of prostitution, or marijuana and heroin stores? Very few voters would approve of a state monopoly owning and actively promoting the use of marijuana. But the state lottery comes very close, by actively inducing people to gamble.

For the politician the problem becomes not only that the state needs the tax money produced by the lottery. The state is actively promoting gambling, an activity that many would see as less socially beneficial than education, for example. And the final irony of a state owned game is that the state is now not just collecting taxes, but is betting against its own citizens. Notice that lotteries and parimutuel tracks are also extremely careful to remind the public that they are merely stakeholders, and the players are betting against each other.

There is little reason to believe that state employed casino operators and dealers would be any more honest or competent than private employees. In fact, a state bureaucracy could make it easier for illegal activities to go undetected, or if detected, unreported, for fear of appearing incompetent to superiors. Any scandal that hits a government owned game would naturally become a political problem for state leaders. Politicians know that a quasi-government body may protect the state from legal responsibilities, but not from political scandal. It is probably for this reason that the idea of government ownership has never been widely supported by political leaders. Government is left with relying upon, and attempting to regulate, private ownership of gambling.

What sort of things do the gambling regulators do? The most important, and time-consuming, governmental function is the constant and repetitive auditing and licensing of legal games. Licensing can run all the way from the charity blackjack games of North Dakota, where all an applicant need prove is that he is a legitimate charity, to the multi-hundred thousand dollar investigations of key employees in an Atlantic City casino.

Regulators also make rules that can affect literally everything that happens with a legal game. Something as important to the players as how many decks of cards are used in blackjack, or where the cut-card is placed, or whether card-counters will be allowed to play at all may be determined by formal regulations promulgated by the government gaming authorities, or by informal pressure by a local inspector.

It is rare that the courts would become involved in the day-to-day running of a legal gambling game, often because there is no basis for a lawsuit. It is rarer still for the state legislature to sit down, study the way the games are being played, and pass legislation to be signed by the Governor. The legislature simply does not have the time, interest or expertise to decide every legal question that arises; that is why it created the regulatory bodies to act in its place.

One of the great dangers in giving government administrators so much independence and power is the likelihood that they will become captive regulators. Of course, there is always the small chance of corruption; a hotel/casino that requires an investment of $400 million, in advance, might be sorely tempted to ensure that it got a license to open. Bribery is already illegal. But the greater risk arises from political and economic pressures that are strictly legal.

Players are not organized; there is no equivalent of the Sierra Club or consumer protection societies for gamblers. Casinos, racetracks and even charity bingo games are not only organized but are expert at lobbying decision makers to protect the high stakes they have invested in their games. The owners and operators are the only people the regulators talk to on a regular basis.

The government administrators have their own investments in the games; what happens to the jobs of the regulators if the companies being regulated go out of business? Who is going to hire someone who allowed the industry he was supposed to oversee to slide into bankruptcy and chaos? On the other hand, if an individual works as a regulator for ten years in a limited field, such as the regulation of casinos, that person has a great deal of expertise, expertise that is practically worthless in the business world outside of the casinos themselves.

George Sternlieb and James W. Hughes, in a recent study of Atlantic City, compiled a table showing the changes, and the potential impact, of regulations affecting Atlantic City casinos. They found a number of new regulations either became effective or were proposed after the casinos had been operating for a few years. None of the rules can be seen to help the players; all are of financial benefit to the casinos. Among the new rules, formally adopted: casinos are no longer required to have $2 minimum tables for blackjack or craps (most now have $5, $10, $25 and $100 tables, thus increasing the house win); the rule of "early surrender" in blackjack was eliminated, hurting the more skillful players; casinos are now allowed to advertise without having to notify the Casino Control Commission in advance; casinos are no longer required to have a minimum number of slot machine personnel, thus cutting down on payroll expenses, although possibly inconveniencing the players.

The difference between the ease with which new regulations are made by the regulators and the difficulty of getting the Legislature to act to amend a statute is illustrated by the proposed 24-hour rule. By statute casinos in Atlantic City cannot be open 24 hours a day, forcing gamblers out into the streets at four or six o'clock in the morning. To provide greater security to players and to increase casino profits it would make sense to allow the casinos to remain open around the clock; yet, this proposal is regularly defeated in the state Legislature. The regulators can only make and change their own rules; they have no power to amend statutes.

You will often hear it said around law schools that the law is a seamless web. Every time you start studying the law in one place the trail leads you to other areas. Gam-

bling law is no different: local leads you to state which leads you to federal; regulations lead you to statutes which lead you to the Constitution. You have to start somewhere, but you also need to know the way the entire system works. The details of any particular law may seem screwy, but actually there is a reason for almost everything in the law. As an example, we will now try to understand why draw poker is legal in California, but stud and hold 'em poker are not.

3

Hold 'em Poker in California

Law schools train future lawyers through the case method: the students are given a large number of actual case decisions, written by courts of appeals, to read and discuss in class. The students' understanding of the law is subjected to rigorous examination through the Socratic method, a not-too-subtle torture of repeated questions by the professor designed to make the students question their every assumption. The students are expected to learn both the reasoning of the judges and the basic principles of law that determine each case. The case method has proven to be an effective, and relatively inexpensive, teaching tool.

To illustrate how the law of gambling works I will use real cases. These will not, however, be dry casebook law. These cases are of current interest. In fact, many are on-going disputes in which I am advising a legal gaming establishment or player.

Chapter Two outlined the various levels of government and the roles of the courts and administrative bodies. How does all this work in practice?

I am currently involved in a long-term fight to bring the game of Texas Hold 'Em poker, known simply as hold 'em, to California. The issue may seem unimportant to people in other states, or to those who do not play poker. But the stakes are big indeed for the dozens of licensed card clubs throughout the state, and for the neighboring poker rooms in Nevada. California has legal card rooms, but play is limited, at the moment, to the card games of draw poker, low ball, panguingue, and pai gow, a Chinese domino game. Thousands of players, and millions of dollars in business, are lost each year to the casinos in Nevada, which allow hold 'em, as well as stud poker.

Hold 'em, stud poker and draw all have the same ranking of hands. It is the differences between the games, not the similarities, that are important. In draw poker you get all of your cards face down, and can draw and replace some cards in an attempt to improve your hand. In stud poker there is no draw; the cards are dealt one at a time to each player in turn, one down and four face up in 5-card stud. Hold

'em also has no draw. Two cards are dealt face down to each player and five cards are turned over in a set order in the center of the table. Those five cards are community cards and become part of each player's hand. The rules for betting differ greatly among the three games. Any standard rule book will show you how these games are played. If you don't know the games take a moment to learn them.

The state Attorney General's office has ruled that only draw poker is legal in the state, all forms of stud poker are outlawed, and playing an outlawed game is a criminal offense. To make matters worse, an Assistant Attorney General (who apparently did not know how to play the game) issued a memorandum that said hold 'em is a form of stud poker, and therefore could not be played for money in a licensed card club.

The state Attorney General's office is an administrative body. You may not have thought about it, but police forces on all levels act like regulatory agencies. Most of the time it is done informally; if the local cops say a game is not against the law, who is going to make the arrests? Often the regulatory function is more formal; law enforcement agencies issue licenses and set up standards for everything from carnival games to Las Vegas Nights. In the case of California the formal Opinions of the Attorney General carry great weight, to the point where they are published, although they are not legally binding. Even informal Memoranda will determine whether local police will act. In late 1984 the Legislature acted to make the regulatory relationship formal; by statute the Attorney General's office shares power with local government authorities to license and regulate card clubs.

So what about the A.G.'s position? If you were the judge, how would you rule? The A.G. has to be wrong; after all, it makes no sense for draw poker to be legal and stud poker and hold 'em to be illegal. End of case, right?

As a law professor my first Socratic question is, "What grounds are there for overturning the Attorney General's decision? You may not like what he has done, but what is your basis, in the law, for saying he is wrong?"

Let's start at the top. What is the role of the federal government? After all, the federal law, and particularly the U.S. Constitution, override every state law. Is there a constitutional right to play hold 'em poker?

Let's try not to get laughed out of court at the beginning. The answer is that the Constitution is not involved. Not because hold 'em poker had not been invented in 1776. The Constitution is flexible enough to handle even the most modern problems; the federal courts have ruled that the original framers of the Constitution meant to include computer software in the protection given copyrights in 1789. But the framers were not concerned with gambling.

Nor is there an act of Congress or any other federal law on the subject. The issue must be resolved entirely under California state law.

What about the California Constitution? The state Constitution is not as silent as the federal; California constitutionally prohibits lotteries. But poker is clearly not

a lottery (more about that later), and the California Supreme Court has held that poker, at least draw poker, is legal and has been so for at least one hundred years.

What about a state statute? Here the issue gets interesting. The California Legislature has been very much concerned with gambling and has passed numerous laws, most of which are still on the books since the gold rush days of 1849.

When the California Legislature created the state's Penal Code in 1872, the lawmakers made it clear that there are no longer any "common law crimes." Put another way, nothing is illegal in this state unless the state Legislature or a local city or county government has made it illegal. It does not matter whether a particular game was prohibited under the common law of ancient England or of another state, any activity, including gambling, is not illegal unless a legislative body has passed a law explicitly making the activity a crime.

The California Legislature has made some forms of gambling illegal, as it has the right to do. Of interest to us are Sections 330 and 331 of the Penal Code, which have been substantively unchanged since 1891.

Section 330 lists the games that are illegal:

> "Every person who deals, plays, or carries on . . . any game of faro, monte, roulette, lansquenet, rouge-et-noir, rondo, tan, fan-tan, *stud-horse poker*, seven-and-a-half, twenty-one, *hokey-pokey*, or any banking or percentage game played with cards, dice, or any device, for money, checks, credit or other representative of value, and every person who plays or bets at or against any of said prohibited games, is guilty of a misdemeanor . . . "

Section 331 makes it a crime to run a gambling house, but is explicitly limited to slot machines and those specific games listed in Section 330.

The effect of these two sections is simple: if a game is one of the twelve listed or a banking or percentage game the game is illegal under the California Penal Code, otherwise it is not. Section 330, by its own terms, sets out the games the Legislature meant to make illegal; even if it did not, the rules of statutory construction require a finding that the Legislature purposely excluded items from the list (here other forms of poker), when it included other, similar items (here stud-horse poker and hokey-pokey). Stud-horse poker, whatever it is, is listed and is therefore illegal; no one can play stud-horse poker anywhere in California for money. Draw poker, lowball draw poker, panguingue, are not listed; these games are therefore legal and can be played anywhere in the state for money, unless prohibited by local ordinance.

The history of these two criminal statutes supports this interpretation. Section 330 is based on a law passed in 1860, which listed six specific games, as well as "banking and percentage games." Poker, as played in a licensed card club, is not prohibited under Section 330 as a banking or percentage game. "The mere payment of rental by the players for the use of the table, cards and chips, or the acting by the proprietor

or dealer as stake-holder, do not convert a game into a forbidden banking game." *People v. Ambrose*, 122 Cal.App.2d Supp. 966, 265 P.2d 191, 194 (1953).

Over the years the Legislature has sporadically added new, specific games, as it saw the need arise.

My research indicates that San Francisco was hit by a stud-horse poker craze around 1880, with scores of poker rooms operating throughout the city. The Legislature reacted to what it saw as an immediate problem. Stud-horse poker was added to the Penal Code's prohibited list by a separate bill passed by the Legislature in 1885. Hokey-pokey was added in 1891.

Despite repeated court rulings that only the games listed in Section 330 are illegal, the Legislature has never attempted to challenge the courts' interpretation of this statute, nor has it acted to rewrite the law. The Legislature could have amended Section 330 to say that these games are merely listed as examples; this it has failed to do, indicating that the lawmakers did, in fact, only intend to outlaw these specific games, as well as banking and percentage games. As the Supreme Court of California stated:

> "Section 330, the principal statute on the subject, prohibits 12 specific games, as well as any 'banking or percentage' game. If the Legislature had intended to regulate the play of any game which is ordinarily played for money or other evidence of value, it would have been very simple to say just that. Not only did the Legislature fail to use the all inclusive phrase, but by other legislation it clearly indicated that it recognized the existence of other gambling games not included in the prohibition of the code section." *In re Hubbard*, 62 Cal.2d 119, 126, 41 Cal.Rptr. 393, 396 P.2d 809 (1964).

Under a new state law, the Gaming Registration Act, and prior case law a local government can license any card game not made illegal under the state Penal Code. Since draw poker and other games are not illegal under the California Penal Code, the question has arisen whether cities and counties in the state can regulate, or even prohibit, these games. That question was decided in a series of California court cases, some dealing with city and county ordinances that attempted to outlaw all "games of chance," and others dealing with city ordinances creating licensed card clubs.

The leading Supreme Court cases are *People v. Lim*, 18 Cal.2d 872, 118 P.2d 472 (1941) and *In re Hubbard*, supra. *Lim* involved an attempt by the district attorney of Monterey County to close down a poker club by means of a court order known as an injunction. The Supreme Court held that it was not within the power of any court to establish the standards for public morality; only the Legislature could decide whether an activity was a public nuisance which could therefore be enjoined under a court's equity power. The Supreme Court explicitly held that even though a gambling house may have been a nuisance under the common law there must be a statute to prohibit this activity or no injunction would issue. There are no statutes prohibiting

the playing of draw poker or making the playing of poker a nuisance. Being a poker club is not enough. (In this particular case the district attorney alleged that the card club was a danger to the public's health and safety because it created traffic and fire hazards, and the Court held those particular allegations were sufficient to get the case to trial.)

This case was followed almost immediately by the case of *Monterey Club v. Superior Court of Los Angeles*, 48 Cal.App.2d 131, 119 P.2d 349 (1941). That same year, 1941, in almost a replay of *Lim*, the district attorney of Los Angeles County attempted to close down a licensed poker club in Gardena by means of a permanent injunction. Gardena had a city ordinance that prohibited anyone from running a card club and charging players a fee to play, unless the club owner had a permit and license for each table. The defendants had the necessary license and had complied with the terms of the city ordinance. Municipalities, such as the City of Gardena, are expressly authorized "to license, for the purposes of revenue and regulation, all and every kind of business authorized by law . . . and lawful games carried on therein." 119 P.2d at 357. If draw poker is not unlawful the City of Gardena could license the game, and being duly licensed it cannot be enjoined as a nuisance.

The Court's conclusion: "Neither playing draw poker nor maintaining a place where it is played being an offense under our law, and therefore being lawful, it follows that the city of Gardena was authorized to license and regulate the operations of such pastime within its corporate limits." 119 P.2d at 357. "Gambling is neither unlawful per se nor a public nuisance per se in California . . . it does not lie within the power of the courts to impose their views as to what is moral or immoral, or what is beneficial or deleterious to public welfare, upon the residents of a community who have legalized the playing of a game not outlawed by statute." 119 P.2d at 358.

Cities and counties are free to license and regulate draw poker and other gambling games that are not outlawed by the state statutes. A question remained for a number of years whether a city or county could completely prohibit a game not included in the list in Penal Code Section 330. The argument by the club operators was that the state had preempted the entire field of gambling, leaving no room for local governments to prohibit a game the state finds unobjectionable.

The Supreme Court resolved the issue in 1964 in the case of *In re Hubbard*, supra. The case involved a Long Beach city ordinance that prohibited the playing of any "game of chance." The game involved was panguingue, which is not prohibited by Penal Code Section 330, but could, conceivably, be a "game of chance" and thus prohibited under the city ordinance. The Supreme Court held that the regulation of gambling is within the police power of a local government, unless in conflict with the general law of the state. The Court held that there was no conflict because the state Legislature had not intended to occupy the entire field of gambling nor the entire field of gaming (all games played with cards, dice or other devices). A local

government is free to supplement the state law; Long Beach can outlaw games of chance within its city's boundaries. If panguingue is a game of chance and if it is played within the Long Beach city boundaries it is illegal under the city ordinance, though not illegal under state law.

A city can thus regulate or even prohibit any game within its city boundaries. It cannot make legal a game that is on the prohibited list of Penal Code Section 330. A city cannot tell another city what to do. If the city of Bell Gardens, for example, wishes to make draw poker legal only the state Legislature can prevent it from doing so.

Any lingering confusion over the status of licensed card rooms should be dissolved by the Gaming Registration Act, which took effect July 1, 1984. Poker is clearly now a legal, regulated industry, authorized by the state Legislature and pursuant to local ordinance. The Gaming Registration Act takes up 26 sections of the Business and Professions Code, beginning with Section 19800. The Act sets up investigative and registration procedures with the state Attorney General. The Legislature intended that local governments could continue to regulate gaming as well. The new registration scheme applies to "legal gambling or gaming."

> "Section 19802. (Operative July 1, 1984) Definitions. As used in this chapter: (a) 'Legal gambling or gaming' means any card game played for currency, check, credit or other thing of value which is not prohibited and made unlawful by Chapter 9 (commencing with Section 319—[Lotteries]) or Chapter 10 (commencing with Section 330) of Title 9 of Part 1 of the Penal Code or by local ordinance. (b) 'Gaming club' means any establishment where legal gambling is conducted and regulated pursuant to local ordinance." Cal.Bus.&Prof.Code Section 19802 (Deering 1984).

"Stud-horse poker" and "hokey-pokey" are the only forms of poker that are illegal under the state Penal Code. So what's the fuss about hold 'em?

A trial judge in the city of Norwalk has decided, preliminarily, that hold 'em poker cannot be played in the Huntington Park Casino, a licensed card club in California. The card club decided it could not afford the costs of an appeal. Other cases are being prepared, and the California Court of Appeal and possibly eventually the California Supreme Court will have to decide whether hold 'em is legal.

Unfortunately, the legal issues have become clouded. The court in the Huntington Park case was not deciding directly whether hold 'em is legal under state law, but rather whether hold 'em was a form of draw poker under the Huntington Park city municipal code.

Every city and county in California is given what is known as a local option to decide whether it wishes to license legal card games. The city of Huntington Park had not chosen to license all forms of legal gambling; the city's municipal code listed the games that could be licensed and stated that all other forms were illegal. The

short list of legal games in Huntington Park included draw poker but not hold 'em, and the card club was faced with the problem of trying to prove that hold 'em is a form of draw poker.

The wording of the Huntington Park city ordinances has created an unfortunate situation for the entire card club industry in California. Card clubs should not be faced with the difficult task of trying to convince a court that hold 'em is a form of draw poker; rather, they should only have to make the easy case that hold 'em is not a form of "stud-horse poker," nor "hokey-pokey," the only forms of poker prohibited by the state Penal Code. The question for the courts should thus be "Is hold 'em a form of stud-horse poker, as the Attorney General claims?" If it is a form of stud-horse poker it is illegal under state law; if it is not then it is legal.

Assuming that the licensed card club industry can get the legal issues back on track, can it prove that hold 'em is not a form of the prohibited stud-horse poker?

The first question is, obviously, what is stud-horse poker?

It is important to understand how the law looks at the question. We are not interested in what the Legislature intends today. You could ask every member of the state Senate and Assembly whether they think stud-horse poker includes hold 'em and the answers would be of absolutely no legal significance. From the law's point of view the question should properly be framed, "What did the state Legislature mean when it included the term 'stud-horse poker' in the list of prohibited games?" Even if there were any legislators still alive from 1885 they are not allowed to testify as to what they meant when they cast their votes. We are only allowed to look at the plain meaning of the words used, and any cases and legislative history that will help determine the Legislature's intent.

Unfortunately, there are no cases interpreting the term stud-horse poker, other than the recent non-binding trial court decision in the Huntington Park case. And state legislatures did not keep records of debates, or practically anything else, in 1885, that would help us know what they meant by the term. The Attorney General's office believes that the Legislature meant to outlaw all forms of stud poker. They further believe that hold 'em is a form of stud poker and therefore is also illegal. They base their conclusions on some hasty research on stud-horse poker and some faulty and speculative reasoning about hold 'em.

In 1947 the District Attorney of Redding asked the Attorney General's office for an opinion as to the definitions of "stud-horse poker" and "hokey-pokey" as used in the California Penal Code. In a short, two-page Opinion a deputy Attorney General wrote that "[I]t is our conclusion that 'stud-horse poker' is identical with 'stud-poker'" and that hokey-pokey "[I]s in substance 'stud-poker' played with four instead of five-card hands." The deputy Attorney General admitted that neither game can be found in any standard reference. He backed up his opinion about stud-horse by referring to undated dictionaries. Stud-horse, he stated, "[I]s defined in Funk & Wagnall's

dictionary as a variant of the term 'stud-poker' and by the Oxford English dictionary as synonymous with the term 'stud-poker.'" He further referred to what he understood to be common usage in 1947.

This 1947 Attorney General's Opinion is of great importance. No licensed card club in the state today deals any form of stud poker.

In 1983 Nancy Sweet of the Attorney General's office, now an attorney for the state lottery, issued a Memorandum regarding a game that she called "Five-Card Hold 'Em." The Memorandum contained a number of factual statements that are questionable at best and indicate Ms. Sweet has never played poker. (For example, she calls the common cards *"the flap."* The correct term is *the flop*, and it applies only to the first three cards turned face up, not to all five community cards.)

Of much greater importance is the completely erroneous legal reasoning she uses to conclude that hold 'em is a form of stud. She thought the legal issue is whether a particular game is one of skill or chance. That simply is not the law in California. Whether a game is predominantly skill or chance has no bearing whatsoever on whether a game is prohibited by the state Penal Code.

Whether a game is one of skill or luck may be the standard for determining whether a machine is a gambling device, like a slot machine, or whether a game is gambling for some other purpose, such as a city or county ordinance that outlaws all "games of chance." But that is not the standard under the California Penal Code. As I showed, and as all California courts agree, if a game falls within Section 330 it is illegal, otherwise it is not prohibited by state law, even if it is completely a game of luck.

As early as 1895 the Supreme Court of California recognized that this is the law in a case involving two types of gambling houses, one in which the game of faro (a popular game of the time) was played and the other involving draw poker. The Court stated in unequivocal terms:

> "The difference between the two places is just exactly as broad as the difference between legality and illegality, or, in other words, since we have none but statutory crimes, it is as broad as the difference between guilt and innocence. Faro is a game prohibited under heavy penalties . . . Poker, played for money, . . . is, in the eyes of the law, as innocent as chess, or any game played for simple recreation; and its votaries, and the places where it is played, are not criminal." *Ex Parte Meyer*, 5 Cal.Unrep. 64, 40 P. 953, 954 (1895).

It is my contention, supported by legal analysis, that the Legislature did exactly what it looks like it did: the lawmakers outlawed one form of poker and one form only.

Stud-horse poker was apparently a variation of 5-card stud with the complicated betting schemes common to poker in the late 19th century. The game's name derives from the legend behind its creation.

During a game of draw poker, so the story goes, a pot was opened by a player

holding three kings. Betting escalated until the opener was out of cash. He flung his hand down and rushed outside to the hitching post, bringing back a spirited stallion.

Realizing that during his absence the other players had probably seen his three kings he made a proposition:

"You fellows know damned well what I'm betting on," he said, "and I've got all my money up on it. Now I propose that to make it fair all around each man turns three of his cards face up—discards two—and draws two more faced down. I'll gamble this here thoroughbred *stud-horse* on my chances."

None of the standard reference works, like Hoyles of 1886, list the game of stud-horse poker. My research indicates that the game was a variation of 5-card stud, and the Attorney General is correct in prohibiting 5-card stud games. It is more questionable whether the Attorney General should be outlawing 7-card stud. There is, in fact, evidence to indicate that the state Legislature in 1885 intended to keep games like hold 'em legal, even though hold 'em was not invented until 80 years later.

The Legislature named the single form of poker it found objectionable. Legal analysis, in the form of statutory construction, requires a finding that any other form of poker that was played in 1885 and known to the Legislature was meant to be kept legal.

It is clear that the Legislature knew about draw poker and did not mean to outlaw that game. Draw poker was invented years before any form of stud and both forms of poker were played throughout California in 1885. There has never been a doubt in the courts or elsewhere that draw poker is legal, because only stud-horse poker is illegal.

What other forms of poker did the Legislature intend to be kept legal when it outlawed "stud-horse poker?" Stud-horse poker is a 5-card game. There is evidence in the statute itself that the Legislature did not intend to outlaw other forms of stud. "Hokey-pokey" was not added to the list of prohibited games until 1891. As the Attorney General's office stated in its official Opinion, hokey-pokey is simply 4-card stud. Apparently the San Francisco card sharks switched from 5-card stud to 4-card stud after the Legislature acted.

Why was it necessary to list 4-card stud if the term "stud-horse poker" had outlawed all forms of stud? And if the Legislature intended to outlaw all forms of stud poker, why didn't it say so instead of listing two specific forms? By the rules of statutory construction, particularly since this is a criminal statute, a court should hold that 7-card stud is not illegal under state law.

What about hold 'em? If hold 'em is a form of 7-card stud, as the Attorney General believes, it is obviously not illegal if all forms of 7-card stud are legal.

But I do not believe that hold 'em is a form of stud, nor is it a form of draw. It is a third form of poker and legal under state law.

Hold 'em is legal for two reasons. The first is simply that it is not illegal. Any

form of poker is legal in California unless it is specifically listed in the Penal Code as a prohibited game. Of course the Legislature could not list hold 'em in 1885, since the game had not been invented at that time. But it was invented later, and it is different enough from "stud-horse poker" and "hokey-pokey" on its face that it is legal until the Legislature makes it illegal.

The second reason is more interesting. Hold 'em is legal because the state Legislature, in 1885, intended that the game be made legal, decades before the game was invented.

How do I know?

What is unique to hold 'em, what makes it different from stud or draw? Obviously, the fact that only in hold 'em are there community cards.

Well, not just in hold 'em. Some of the ancient French and Italian games that contributed to the modern game of poker had community cards. And good old spit-in-the-ocean has a community card. In spit-in-the-ocean each player receives four cards face down and there is one card dealt face up which is wild and is part of each player's hand.

It was the San Francisco poker boom of the 1870's and 1880's that led to the outlawing of stud-horse poker. During that boom, all varieties of poker then in existence were played, including spit-in-the-ocean. The state Legislature knew this game was played and did not move to outlaw it.

The California Legislature knew that a form of poker involving a community card was being played in the card rooms of the state and intentionally left the game alone while outlawing a 5-card stud game known as stud-horse poker. The Legislature intended that this other form of poker continue to be played in legal card clubs throughout California.

The lawmakers of California acted with careful purpose in 1885 when they outlawed stud-horse poker—they intended that that game and that game alone be illegal, and that other games, including spit-in-the-ocean, continue to be legal. And after all, isn't spit-in-the-ocean simply a form of one-card hold 'em?

4

The Federal Law of Gambling

Take your mind back to a simpler time, a time of horsedrawn carriages and candlelit dinners. Back to the time of the American Revolution; a time of adventure and discovery. It was also a time of experimentation: great men were attempting to unlock the secrets of electricity and the elements. Others were experimenting with a radical idea: democracy. Was it possible to create a government that was both strong and free, flexible yet consistent? Could 13 independent states retain their rights as independent sovereigns, yet give up some of their rights to a new federal government that would be the supreme law of the land?

The very idea of the United States Constitution and our federal system of government is so impossible that it is amazing that it even was accepted, let alone that it retained much of its vitality for almost 200 years. The rights and the systems we take for granted simply do not exist, and can hardly be conceived of, in most of the rest of the world. We all know about the lack of personal freedoms in Iran, the Arab countries, Africa and the Communist world. But imagine trying to explain a concept like a dual federal/state court system, or the idea that the central federal government cannot do something because the states have not given it the power.

Even Americans sometimes forget that our federal government is a government of limited power; limited not only by the Bill of Rights, but also because the people have not authorized the power in the Constitution. One reason we forget is because many of the limitations on the federal government have been eroded away, by the actions of Presidents since Franklin Delano Roosevelt, by Congress in passing laws and creating a massive federal bureaucracy, and by the United States Supreme Court.

In the last 80 years, the U.S. Supreme Court has greatly expanded the scope of federal jurisdiction, the fundamental power of the federal government, far beyond the visions of our colonial patriot fathers.

The Ninth and Tenth Amendments, parts of the original Bill of Rights, explicitly

state that powers not given to the federal government are reserved to the people and the states. The U.S. Constitution places what appears to be rather severe limits on federal jurisdiction, usually through silence. For example, Congress is explicitly given the power to regulate "interstate commerce;" therefore, Congress and all of the rest of the federal government do not have the power to regulate *intrastate* commerce.

One of the U.S. Supreme Court's most important cases, the first to greatly expand the meaning of the phrase "interstate commerce," was the "Lottery Case," decided in 1903. The Supreme Court ruled that the federal government had the power to regulate legal state lotteries, because the lottery tickets were shipped from one state to another. Prior to this case the interstate commerce clause had acted as a severe restriction on the federal government's power to become involved in any legitimate business, or even to control criminal activity. The general perception had been the federal government was limited to dealings with foreign countries and "real" interstate commerce, such as interstate waterways and railroads.

The Lottery Case was the first of a large number of court decisions, each one pushing the limits of "interstate commerce" further away from a layman's view of the term. The high court has gone so far as to hold that the federal government has jurisdiction so long as there would be an impact on interstate commerce, even if the individuals or businesses involved never leave their state.

Whether or not the expansion of the federal government's power has been justified, or possibly even necessary, is beyond the scope of this book. I will note in passing that I have been unable to use a legal term, "state's rights," to describe the relationship between the states and the federal government because that term has taken on a completely different meaning in the popular press: segregation. If a state government can use its "state's rights" to discriminate against its own citizens, perhaps the Supreme Court was justified in expanding the federal government's power to protect those citizens. But one evil has lead to another. The law is warped when a state discriminates against its own citizens, but it is just as warped when the Court finds there is "interstate commerce" because a segregated motel buys its hot dogs from another state.

For gamblers the expansion of federal jurisdiction means that the use of a means of interstate communication, such as a telephone line, gives the feds the power to intervene. Most of the fugitives on the FBI's (the *Federal* Bureau of Investigation) Ten Most Wanted list have never committed a federal crime, except one: crossing a state line to avoid prosecution for a state crime. And the federal courts can be even more creative than that in finding federal jurisdiction.

It is a *federal* crime for five or more individuals to operate a gambling business that is illegal under *state* law. This law allows federal prosecutors to make a violation of a state gambling law into a federal offense. No direct interstate commerce need be involved, yet the courts have held that there is federal jurisdiction. The theory

supporting the exercise of federal power is that an organized gambling ring must, by its very nature, have a significant impact on interstate commerce.

It would be interesting to see if a defense attorney would be allowed to raise the issue that no interstate commerce was actually involved, and therefore, the federal government has no jurisdiction over this offense.

I was able to raise a similar defense in a case involving a defendant charged with the federal crime of being an ex-convict in possession of a gun. I was able to show that the defendant had not carried the gun across a state line, and therefore the federal government had no power to make his mere possession of the gun a crime. The federal judge dismissed the charges. (The defense should not succeed today; the United States Supreme Court has ruled that interstate commerce is involved so long as the gun has *ever* been shipped across a state line.)

There is no such thing as "federal common law" in terms of judge-made law, the way there is common law in the state courts. In deciding what is a state's common law, courts are free to decide what they think the law should be. An activist court, like the California Supreme Court, can make and change the law at will, unless limited by statute or constitution. In theory, federal law is quite different. Every federal law must be based on either the United States Constitution or an Act of Congress. Of course, as can be seen by the expansion of the term "interstate commerce" the federal courts can be pretty free in interpreting federal statutes and even the Constitution.

There are two major restrictions on federal power today, one legal and the other practical. The legal restriction is the United States Constitution itself. The practical restriction is the limits faced by Congress due to a lack of time, interest and politics.

Federal laws are the supreme law of the land, in a direct conflict between a valid act of Congress and a state law the state law must give way. But even federal laws are subject to the restrictions imposed by the U.S. Constitution. Although the interstate commerce clause of the Constitution may have lost all of its meaning, other parts of the Constitution clearly still have great force. Congress cannot, for example, violate an individual's free speech; the first amendment explicitly states that "Congress shall make no law . . . abridging the freedom of speech, or of the press." Of course, it is up to the courts to decide whether free speech has, in fact, been violated.

The second limitation on the power of the federal government is much more practical. There is only a limited amount of time to deal with a tremendous number of pressing problems. Even with the help of the federal bureaucracy not every matter of potential federal interest can be studied and dealt with. In addition, there are political pressures. Some issues seem best left to the states.

I have no doubt that Congress could completely outlaw virtually every form of gambling overnight, simply by declaring every commercial bet illegal under its power to regulate interstate commerce. Such a complete prohibition would not violate the

Constitution; Congress would not be taking away a fundamental right like free speech, it would only be taking away your right to gamble.

Think of imported cars. Congress may decide that imports hurt the American economy by throwing off our balance of payments and throwing U.S. workers out of jobs. It would be unconstitutional for Congress to pass a law making it a crime for a car dealer to advertise foreign cars; that violates the constitutional protection on free speech. But it would be perfectly legal for Congress to completely forbid the importation of foreign cars. Only interstate commerce is involved; there is no constitutional right to sell cars any more than there is a constitutional right to gamble.

The distinction is important because Congress has not attempted to prohibit legal gambling, only to regulate and limit it, particularly through limits on advertising.

What follows is a complete list of the federal law of gambling. The statutes passed by Congress that become law are compiled in a set known as the United States Code (U.S.C.). I conducted a comprehensive law library and computer search of the federal statutes and uncovered every federal law that mentions or is related to gambling.

7 U.S.C. Section 12a—Allows the Commodity Futures Trading Commission to refuse to issue a license to a broker, commodity investment advisor or anyone else connected with the trading of commodity futures who has been convicted of embezzlement, theft, extortion, fraud, bribery or gambling. This is obviously not a biggie in the world of gambling law. But it is interesting to note how the federal government lumps "gambling" with serious felonies, while permitting the legal gambling of commodity trading to flourish on a grand scale. This is not simply my editorial opinion. Trading on commodity exchanges rivals in size the billions of dollars bet each year in casinos and at the track; and, commodity futures are a form of gambling. (See 15 U.S.C. Section 78bb, in this chapter.)

8 U.S.C. Sections 1101 and 1182—The federal government can exclude aliens convicted of various crimes, including illegal gambling. The Immigration and Naturalization Service uses these laws against individuals with a history of violations, particularly those it suspects are entering the United States to engage in illegal commercial gambling.

11 U.S.C. Appendix, Bankruptcy Rules, Form 7—Anyone filing for bankruptcy must state whether he has lost anything gambling during the year, including "dates, names, and places, and the amounts of money . . . lost."

12 U.S.C. Sections 25a, 339, 1730c, 1829a—States that national banks, state member banks, federally insured savings and loans, and federally insured non-member banks may not participate in any lotteries, and may not even "announce, advertise, or publicize the existence of any lottery." The statute specifically allows banks to accept money and otherwise act as banks for state lotteries.

15 U.S.C. Section 78bb—Exempts puts, calls, options and other securities traded on a national exchange from being outlawed by state laws. This federal law was

necessary because some states, particularly in the South, passed laws against gambling contracts and "bucket shops," brokerage houses that in effect bet with their customers whether stocks would go up or down. Many of the forms of trading in stocks and commodities that are now generally accepted in the financial community would be outlawed under these state laws as illegal gambling. The state anti-gambling laws required that the purchaser accept delivery of the product, clearly an impossibility for the speculator. The minimum size for one contract of pork bellies is 38,000 pounds. Imagine the fun of having 19 tons of raw bacon delivered to your front door. Similarly, the new options on indexes, where you can bet on such things as the New York Stock Exchange Index, do not involve real products: you cannot ask for delivery of the actual stock.

15 U.S.C. Sections 1171-1178—The Johnson Act, created out of Senator Estes Kefauver's well-publicized investigation in 1950 of organized crime and gambling. Makes it a federal crime to transport an illegal gambling device across a state line. The law requires that even legal manufacturers must register with the Attorney General and keep complete records of all buyers. The law applies to "any person engaged in the business of manufacturing gambling devices, if the activities of such business in any way affect interstate or foreign commerce." Section 1175 prohibits the use of gambling devices in the District of Columbia, within Indian country, and within U.S. territorial waters. Violations of the law result in confiscation and forfeiture, and up to two years in prison and a $5,000 fine. Interestingly, parimutuel betting machines are exempt, as are coin-operated pin-ball machines.

15 U.S.C. Sections 3001-3007—Federal regulation of interstate off-track betting. Congress specifically found that "the States should have the primary responsibility for determining what forms of gambling may legally take place within their borders;" and, "the Federal Government should prevent interference by one State with the gambling policies of another." The federal government has no interest in horse racing beyond regulating interstate bets. The statutes set up all sorts of requirements for legal, interstate OTB. As a demonstration of the power of the tracks the law requires that an OTB office obtain the prior consent of the "host" racing association (and its horsemen's group), the host racing commission, off-track racing commission, and all currently operating tracks within 60 miles of the OTB office; and if there are no currently operating tracks then the closest currently operating track in an adjoining state. In the West this could give a track hundreds of miles away veto power over a neighboring state's OTB. There are, however, no civil penalties for violating the law, other than for the OTB to give the host state, racing association and horsemen's group the money it illegally obtained.

18 U.S.C. Section 224—Makes sports bribery a federal crime.

18 U.S.C. Sections 1081-1083—It is unlawful for a U.S. citizen, or anyone on an American vessel, or anyone on any vessel inside U.S. waters, to set up a gambling

ship. This is an American law with worldwide impact in the 1980's and 1990's; the gambling ships that ply the Carribean cannot be American flagships. It was passed in 1948 for the much more limited purpose of outlawing casino ships that anchored just outside the territorial waters of California.

18 U.S.C. Section 1084—It is a crime if anyone "engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest . . . " A Federal court has held that this statute applies only to bets that are illegal under state law. It would be unconstitutional for the federal government to prohibit a legal sports book from using interstate wire facilities.

18 U.S.C. Sections 1301-1307—These are the main federal anti-lottery laws. Section 1301 makes it a federal crime to carry or send a lottery ticket, or lottery information, or a list of lottery prizes in interstate or foreign commerce; and, Section 1302 specifically prohibits the use of the mails for checks for the purchase of tickets, and for "any newspaper, circular, pamphlet, or publication of any kind containing any advertisement of any lottery, gift enterprise, or scheme of any kind offering prizes dependent in whole or in part upon lot or chance . . . " Postal employees cannot sell lottery tickets, Section 1303, and neither can other specified federal agencies, Section 1306. The Postal Service seems to limit its enforcement powers mainly to illegal lottery-type schemes; although, few legal lotteries have had the courage to attempt to use the interstate mails.

The Federal Communications Commission (FCC) has not felt its power to be so limited. Section 1304 makes it a federal crime to broadcast "any advertisement of or information concerning any lottery, gift enterprise or similar scheme," etc. The FCC has promulgated a formal rule stating that radio and television stations cannot carry lottery information. Informally, the FCC has interpreted the prohibition to apply to virtually every form of gambling, including all legal games such as bingo, and all casino advertising. Horse racing was exempted as a game of skill or a sport. Some casinos have taken to cable television since the FCC seems to define "broadcast" as not covering cable.

The federal anti-lottery laws were so pervasive that Congress found it necessary to pass two special statutes, Section 1305 exempts fishing contests and Section 1307 makes limited exemption for legal state lotteries. State lotteries can advertise in adjacent states, but only if that adjacent state also has a state lottery.

18 U.S.C. Section 1511—Makes it a federal crime for an elected or appointed state official to conspire to obstruct the enforcement of the criminal laws of a state, with the intent to facilitate a large-scale, illegal gambling business. There are additional tests that must be met before the state official goes to federal prison, such as the illegal business must have five or more people managing or owning the operation

and the business has to be in substantially continuous operation for over 30 days or have a gross revenue of $2,000 in any single day.

18 U.S.C. Sections 1951-1955—The Racketeering statutes, including the Hobbs Act (Section 1951) and the Travel Act (Section 1952). Makes it a federal offense to travel or use any facility in interstate or foreign commerce, including the mail, with intent to promote or carry on any unlawful activity. "Unlawful activity" is specifically defined to include "any business enterprise involving gambling," as well as alcohol and drugs. Section 1953 covers the interstate transportation of illegal wagering paraphernalia. Section 1955, part of the Organized Crime Control Act of 1970, makes it a federal crime to conduct or own a gambling business outlawed under state law. This new federal crime is limited, like Section 1511, to large-scale operations. The law also gives the federal government the right to seize and keep all money and property used in the illegal business. These laws have been effective in closing down open illegal casinos and bookmakers with interstate layoff business, but are less successful with smaller, more clandestine operations.

18 U.S.C. Sections 1961-1968—Racketeer Influenced and Corrupt Organizations, commonly known as RICO. This is the new darling of the federal prosecutors, making it a new federal crime if you commit two other specified crimes within the last ten years. One plus one equals three. The other crimes may be state or federal and include Section 1955, listed above, or the use of threats to collect illegal gambling debts, the Hobbs Act (Section 1951). Courts have held there is no violation of double jeopardy: you can be convicted and serve time for the two crimes and be convicted and serve additional time for RICO. The penalties are stiff, including prison sentences and the forfeiture of all property associated with the illegal organization, and convictions are relatively easy to obtain.

RICO also creates a new civil cause of action, and private companies have been suing each other charging RICO for such things as violations of the federal securities laws. RICO was intended to give federal prosecutors the power to reach organized crime bosses, the men who gave the orders but never dirtied their hands. And it has been successful, to some extent, in convicting the higher-ups. But the law is so broad in its reach that it has been used against such "racketeer influenced corrupt organizations" as IBM. Under RICO the prosecutor (or plaintiff in a civil suit) need only charge that the other two crimes have been committed, it is not necessary for the defendant to have been convicted of those crimes.

18 U.S.C. Section 2516—Allows the Federal Bureau of Investigation to apply to a federal judge for a wiretap for a suspected bomber, assassin, child molester or violator of the federal gambling laws.

19 U.S.C. Section 1305—Prohibits the importation into the United States of "immoral articles," including lottery tickets and advertisements. If found in a package, the entire contents of the package are subject to seizure and forfeiture.

20 U.S.C. Section 107a—Allows the blind, only, to sell lottery tickets on federal land.

25 U.S.C. Section 1747—The Florida criminal laws, including Florida's anti-gambling laws, will apply to land transferred from Florida to the United States government for the use and benefit of the Miccosukee Tribe of Indians. This and similar laws may seem silly and unimportant, but they are very important indeed—to the Indians, gamblers and charities running competitive bingo games. The federal courts have ruled that a state can make gambling a crime both on and off the reservation, but once the game is not "criminal" the state laws do not apply.

26 U.S.C. Section 61—The bane of a gambler's (and every other taxpayer's) existence. This Section of the Internal Revenue Code provides the basis for taxation of all income, including gambling winnings. Since literally every winning bet is supposed to be reported, I suspect more people violate this tax law than any other law ever made. Non-reported tips are probably a close second. See Chapters Nine and Ten.

26 U.S.C. Section 103—The Internal Revenue Code. Industrial development bonds (a relatively new idea where a local area raises tax-free money to aid a developing business) cannot be used to build any facility used for gambling. This means a city can pass a bond issue to get in a plant that makes napalm but not for a casino or a jai alai fronton.

26 U.S.C. Section 165(d)—The only break for gamblers—losses are deductible up to the amounts won during the year. More on this in the Case Study in Chapter Ten on taking gambling losses off your taxes.

26 U.S.C. Sections 168(h)(1) and 48(a)(6)—Gives a big tax break for breeders of race horses. Run of the mill horses must be over 12 years old to depreciate over a three year schedule; race horses need be only two years old to gain this superfast write-off.

26 U.S.C. Section 183—Another tax break for the race horse industry. Only those taxpayers involved in the breeding, training, showing, or racing of horses have a presumption that they are engaged in a business for profit, and can thus take all their expenses off their taxes, even though they only made money in two out of seven years.

26 U.S.C. Section 513—Allows charities to run for-profit bingo games without losing their status as tax-exempt charities.

26 U.S.C. Section 1231—A last tax break for horse breeders. Horses held for breeding or sporting purposes are given special treatement for capital gains and losses.

26 U.S.C. Section 1441—Requires 30% withholding of income paid to nonresident aliens, including gambling winnings. See Chapter Ten.

26 U.S.C. Section 3402(q)—The tax code, continued. The federal government withholds 20% of certain gambling winnings for tax purposes, not trusting big winners to pay. Withholding is generally required on proceeds from state lotteries exceeding $5,000 and on proceeds from sweepstakes and other lotteries exceeding $1,000.

Proceeds exceeding $1,000 from parimutuel pools are subject to withholding only when the amount won is over 300 times the amount bet. Winnings from slot machines, keno and bingo are specifically exempted; however, the winner is required to supply information for a tax form (a W-2G), which states, under penalty of perjury, the name, address and taxpayer identification number of the winner. For more on federal withholding see Chapters Nine and Ten.

26 U.S.C. Sections 4401-4424, 4901, 4902, 4904-4906, 6419, 7262—Sections 4401 to 4424 are Chapter 35 of the Internal Revenue Code, entitled "Taxes on Wagering." This chapter sets up special taxes on gambling, both on bets placed and on the business side of the operation. There is an excise tax imposed on wagers: one-quarter of one percent of the amount bet legally and two percent of illegal bets. The operator who runs the gambling game is liable for the tax, much the way a store owner acts as the tax collector on sales tax. In addition, gambling operators must pay an occupational tax of $500 per year for illegal games and $50 per year for legal operators.

Every person required to pay these special taxes must register with the Internal Revenue Service and keep a daily record showing the gross amount of all wagers. This registration requirement used to be the "silver platter" doctrine: if you were an illegal gambler who failed to pay the tax you could be arrested for tax evasion; if you paid the tax the I.R.S. would hand you over on a silver platter to state prossecutors for illegal gambling. The United States Supreme Court stopped that self-incrimination nonsense in 1968, and the information as to who has paid these taxes is now not available to law enforcement, except for investigation of evasion of the taxes themselves.

The excise and occupational taxes apply to everyone who is engaged in the business of accepting wagers, except licensed parimutuels, coin-operated devices, and state lotteries. Games such as craps and poker are exempt under the strict definitions contained in Section 4421, which defines "wager" and "lottery." The law is mainly concerned with bookies and the numbers game, and even these get something of a break. Section 6419 allows a credit for wagers laid-off to another; this prevents double taxation; even illegal bookies have their rights.

The other sections deal with procedures for collecting the taxes, including penalties for failing to register.

For more on the special taxes on wagering see the chapters on taxes.

26 U.S.C. Section 5723—Makes it illegal to attach a lottery ticket to a package of tobacco products (also indecent or immoral pictures, in case you were thinking of trying).

29 U.S.C. Section 1813—The Secretary of Agriculture can refuse to issue a certificate to a farm labor contractor who has been convicted of any crime involving gambling.

39 U.S.C. Section 3005—This is the main mail fraud statute, but it also gives the Postal Service the authority to intercept and return lottery mail. Although only state lotteries are exempted by the language of the statute, the Postal Service seems to be concerned primarily with illegal schemes, and not other forms of legal gambling. The government is greatly restricted, under the constitution, from opening private mail.

43 U.S.C. Section 1353—Allows the federal government to conduct a lottery to sell its oil by means of a lottery. Although this is not a gambling statute it is interesting to compare the federal government's open support for lotteries when it serves its own purposes. The federal government sees nothing wrong in using a lottery to distribute broadcast licenses, or land, or that most famous lottery of all—the draft. Compare this with the strict restrictions on lotteries run by private citizens or other governments, such as in 19 U.S.C. Section 1305, 39 U.S.C. Section 3005, Title 12 dealing with banks, and the broad prohibitions in the anti-lottery acts, 18 U.S.C. 1301-1307.

This may seem like a long list, and the impact of the federal government can be great when it chooses to act. But compared to the thousands of laws considered by Congress every year, the federal intervention in virtually every other part of American life, and the active control of gambling by the states, Congress has not been active in controlling either legal or illegal gambling.

Congress has also created a number of federal administrative bodies, each with the power in specific areas to make rules and regulations, conduct hearings, and even impose penalties. Often the violation of an administrative regulation is in itself a federal crime. And the federal bureaucracies have tremendous power in granting and revoking licenses, and simply making life complicated.

The Internal Revenue Service, for example, has formal Regulations that are four times as long as the Internal Revenue Code, and taxes are an area where Congress has been active. In an area like radio and television broadcasting, Congress has let the Federal Communications Commission make practically all of the law, with very little guidance from above. The FCC prohibits the broadcasting of information related to lotteries, and has interpreted the term "lottery" to include virtually every form of gambling, both legal and illegal.

The Bureau of Alcohol, Tobacco and Firearms has the responsibility for enforcement of the wagering occupational tax and the excise tax on wagers.

Other federal regulators are important for gambling. The Federal Trade Commission, which has a broad mandate to prevent "unfair trade practices," once actively restricted advertisements, including gas station game cards, as forms of gambling, and ruling, by inference, that gambling is an "unfair trade practice." The FTC still imposes strict rules on commercial sweepstakes. The United States Postal Service, has the power, which it uses only sporadically, to prosecute mail frauds and to pro-

hibit lottery information from the U.S. mails. The United States Treasury, which includes the Internal Revenue Service and the Bureau of Alcohol, Tobacco and Firearms, has imposed a regulation that requires casinos to keep detailed records and file reports with the identity of every player involved in a cash transaction of over $10,000. The Securities and Exchange Commission has extensive power over publicly traded stocks and bonds, including the securities of companies involved in gambling. The Department of Justice, which includes the Federal Bureau of Investigation and the United States Attorneys, prosecutes federal offenses.

Special forms of gambling have to face special federal agencies. The Department of Defense changes its rules every few years on whether and where slot machines will be allowed on military bases. Sometimes the Department of the Army says yes while the Department of the Navy says no; other times Europe is okay but Asia is not. The Department of the Interior's Bureau of Indian Affairs (BIA) plays an important role in gambling on Indian reservations: the BIA said yes to Indian Bingo, but no to Indian prostitution. (Indian tribes are not necessarily limited by state laws.)

Federal regulatory agencies have great independence, and are not consistent in the way they make their regulatory decisions. Most issue formal rules and regulations, adopted after public hearing. Most also conduct hearings, for such things as license applications. Some will even give you formal or informal opinions through the mail or by phone, in advance, so you will know if what you plan is legal. All have informal procedures, which can only be learned by contacting an attorney who handles cases in front of that particular agency on a regular basis.

Although the federal agencies are extremely powerful, if the stakes are big enough they can be challenged. Agencies have to follow their own procedures and the general rules of procedure set down by Congress. Often an agency decision can be overturned because the agency failed to follow its own rules, which is understandable because there are so many rules, and they are usually written in a form of legal bureaucratese that no living human being can understand. Lower level decisions by hearing officers can be appealed to higher levels within the agency. If the case is worth the cost and trouble, you can appeal to the courts.

The federal courts have been known to reverse agency decisions, although this does not happen all that often. The point of creating administrative agencies is to free the courts from dealing with problems that are either routine or require expertise. If every case could be appealed successfully to the courts there would be no reason to have the agencies in the first place.

However, there are limits to how much the courts will let the agencies get away with. Federal agencies were created by Congress; they cannot exercise more power than Congress has given them; this is known as the "delegation doctrine." And the federal bureaucracy certainly cannot do something that Congress itself could not do. Congress cannot violate a citizen's right to free speech, and the administrative agen-

cies cannot violate that right either.

Or can they? The Federal Communications Commission has repeatedly denied legal gambling the right to broadcast its ads over radio or television. A subcommittee of the United States Senate said that was an unconstitutional invasion of free speech, and so did the United States Department of Justice. Can a legal casino be prevented from advertising? That is our next case study.

5

Legal Gambling's Right to Advertise

One of the hottest issues of the 1980s in the field of legal gambling is the fight over the right to advertise. The present situation is confused and the "law," when we can find it, is irrational and contradictory.

State lotteries advertise on television, radio and in the newspaper; yet, legal charity bingo games cannot even announce when a game is cancelled on account of rain. Racetracks blanket the airwaves with commercials and entire races are broadcast on television, including the betting odds; yet, licensed card clubs cannot even broadcast their business hours over the air. Casinos advertise only on cable television; if you see an ad for Las Vegas or Atlantic City on regular TV you will notice they only mention their restaurants, hotel rooms and shows.

The situation has gotten to the point where a game like blackjack cannot be advertised, because one branch of the federal government considers it a "lottery," unless it is played in a tourrament, then it becomes a game of skill. And a casino owner cannot answer requests for information through the mail, other than to send a four-color brochure of the golf course and spa.

The right to advertise can make the difference between success and bankruptcy for a business that requires large public attendance. A major motion picture, for example, may spend $20 million in advertising, just to get the customers through the theater doors. How did it come about that legal gambling is the only legal business in the United States that is not generally allowed to advertise?

The main culprit has been the Federal Communications Commission (FCC), which regulates and licenses all broadcasters in the United States, and a set of federal anti-lottery laws passed before the turn of the century. State lotteries are allowed to run commercials under special rules. But as for other forms of legal gambling—the FCC

has instituted what can only be regarded as a reign of terror, deciding without rhyme or reason what forms of gambling can advertise over radio and television and what forms cannot. A federal statute prohibits the broadcasting of information relating to lotteries, and the FCC staff, the non-elected bureaucrats who interpret FCC policy, have let radio and television stations know, informally, that virtually every form of gambling is a "lottery."

The FCC also has the power to regulate cable TV, but has apparently decided that casinos can advertise on cable, since cable ads are not "broadcast."

The FCC does not have the power to regulate the U.S. mails, but the U.S. Postal Service and the U.S. Department of Justice do. There are additional federal laws prohibiting the transmission of lottery information through the U.S. mail. Fortunately, the Postal Service has better things to do, although it will intercept commercial advertisements and lottery tickets, particularly if the game is an illegal lottery scheme. The Department of Justice, which is, after all, the law enforcement arm of the federal government, questions the constitutionality of all these laws. The U.S. Attorneys and the other lawyers in the Department of Justice limit their enforcement of the anti-lotteries laws to illegal enterprises since they feel it is a violation of the constitutional right to free speech to prevent a legal business from advertising.

At the moment, no federal agency regulates newspapers or the content of billboards, probably because neither involves interstate commerce. Casinos and other legal games spend large sums posting signs and taking out ads in newspapers that are hand delivered (mailed newspapers are prohibited).

All attempts to control the FCC or get the law changed in Congress have so far been unsuccessful.

The federal law is the main obstacle to open advertising. A lawyer may, in addition, have to interpret and possibly overcome state and local laws. The only way to know whether a particular game can advertise in a particular way is to study the specific laws involved, including everything from the United States Constitution and the federal statutes and regulations, through the state constitution and statutes, down to the local city and county ordinances, regulations and licenses.

As an example, a licensed card club in California found that every radio and television station in its market area refused to broadcast any information about the club's legal poker games, including paid commercials. The club retained me to help it win the right to advertise. After considerable legal research I issued a lengthy formal Legal Opinion explaining why, in this particular case, the legal game involved could advertise. The Federal Communications Commission disagrees; however, my Legal Opinion convinced at least two popular radio stations to run the club's commercials.

The federal law of gambling begins with the United States Constitution. The Constitution both empowers Congress to make laws in designated areas while it protects the rights of individuals against Congressional action. Congress, in turn, has passed

statutes in some areas of gambling law but has been inactive in others. Congress has also passed other laws creating the federal bureaucracy and delegating to those administrative agencies the power to regulate certain areas of our life.

The Federal Communications Commission was given the power to enforce the anti-lottery broadcast law, along with general power over the airwaves. In the law we call that delegated power; the elected representatives in Congress found they did not have the time to debate every radio license or broadcast regulation that might be made. Congress delegated all of its power to the FCC and now the FCC has the same power Congress has.

Clearly, Congress had the power under the Constitution to make the anti-lottery laws. Or did it? Interstate commerce is definitely involved, and the Constitution explicitly gives Congress the power to regulate the U.S. mail. But Congress cannot violate the other sections of the Constitution. Since the Constitution prohibits restrictions on free speech, the question becomes whether a complete prohibition on the free speech of a legal lottery violates that organization's constitutional rights and the constitutional right of citizens to hear what the legal game has to say.

The question has not been decided, but the United States Supreme Court has ruled that it is unconstitutional for the government to completely suppress the advertising of a legal enterprise. Since Congress cannot violate a legal gambling game's right to free speech, the FCC, which has only delegated power, also cannot restrict the legal gambling game's right to advertise. Thus, in a conflict between a federal law or regulation and the U.S. Constitution, the federal law must give way; the court should declare the ban on lottery advertisements as unconstitutional.

Actually, there is no need to deal with tough constitutional questions. The FCC staff has interpreted the term "lottery" to include all forms of gambling, including card games such as poker and blackjack; charity bingo, beano and similar games; and all casino games, including craps, roulette and slot machines. No station has had its license revoked for running a "lottery" commercial, but very few ads have ever been run since stations have been unwilling to buck their regulators.

The FCC allows information about betting on horse racing by interpreting handicapping as involving skill, or because horse racing is a sport. Of course, if horse racing were merely a sport like football there would be no need to broadcast information as to the odds and pay-offs. Tournaments have also been informally exempted as requiring skill, even slot machine tournaments.

The short answer is the FCC is wrong.

Card games like poker, pan, blackjack and gin, are clearly not lotteries under any definition of the term and are not prohibited from advertising under the language of the statute.

Casino games like craps, slot machines and roulette are a little more difficult to distinguish. In many ways they are like lotteries in that money is pooled from all

the players and an individual player has no control over the outcome. However, in many ways they are different, the most important being that the player has to be physically present to play. The Nevada Supreme Court, for example, specifically ruled that slot machines were not lotteries; lotteries are prohibited under the Nevada Constitution.

Bingo, keno, beano and the like are the most difficult to distinguish from traditional lotteries. One federal court ruled that keno is a lottery; although, keno and bingo are legal in Nevada. The difference may lie in the specific language used in the laws. The federal law prohibits the advertising of any "lottery, gift enterprise, or similar scheme, offering prizes dependent in whole or in part upon lot or chance." The Nevada Constitution states "No lottery shall be authorized by this State, nor shall the sale of lottery tickets be allowed." It is thus possible that keno and bingo are not lotteries under the specific Nevada law but are "similar schemes" under the language used in the federal law.

As you can see by the above analysis, the first step in any legal analysis of a law or regulation is to see whether it applies to the specific set of facts under consideration. The actual language of the statute or other government activity is scrutinized to see what exactly is prohibited and what is allowed.

When dealing with supposed restrictions on any form of speech (and advertising is a form of speech) a second step is required. The prohibition is tested against standards established by the United States Supreme Court to see whether the governmental action is an unconstitutional infringement of free speech.

In other words, the tests are what exactly is the government action and does it apply in this specific case; and second, is the government action constitutional.

The starting point of our legal analysis are the actual words used by Congress. It turns out there are very few federal laws that purport to restrict the dissemination of information about gambling in the United States. The United States Criminal Code sections entitled "Lotteries," 18 U.S.C. c. 61, Sections 1301 to 1307, the Postal statute, 39 U.S.C. Section 3005, and other federal statutes dealing with federally insured financial institutions, 12 U.S.C. Sections 339, 1829a, 1730c, contain some broad language relating to lotteries.

The principal limit on broadcasting is found in Title 18 Section 1304 of the United States Code, which states:

> "Whoever broadcasts by means of any radio station for which a license is required by any law of the United States, or whoever, operating any such station, knowingly permits the broadcasting of, any advertisement of or information concerning any lottery, gift enterprise, or similar scheme, offering prizes dependent in whole or in part upon lot or chance . . . (shall be subject to punishment)."

The federal statutes were changed by Congress in 1975 to create some limited exemptions for state lotteries. State lotteries alone can advertise and use the mails, though they are permitted to advertise only in limited ways, such as broadcast advertisements within their own states, or in neighboring states, but only if the neighboring state also has a state lottery.

The original anti-lottery mail statutes were passed in 1890 in response to the Louisiana Lottery scandal. Congress had tried for 24 years to stem the tide of lottery schemes, which the individual states seemed unable to control. Lotteries continued, however, and pressure grew on Congress to act. President Benjamin Harrison sent a special message to Congress asking them to pass legislation to eliminate the Louisiana Lottery.

The legislative history of the statutes indicates Congress meant to limit lotteries, whether legal or illegal, but lotteries only.

The federal government's prohibition on the use of the mails by lotteries was expanded to include broadcasting of lottery-related information as part of the Communications Act of 1934. It is important to note the date, 1934, and the fact that Congress again used the word "lottery." It is impossible to believe that Congress did not know that many other forms of gambling were legal in 1934—Nevada had legalized all forms of casino gambling, to national publicity, just three years earlier.

The broadcasting statute used the exact same language contained in the mail anti-lottery statutes. There is no indication that Congress intended the phrase, "lottery, gift enterprise, or similar scheme offering prizes dependent in whole or in part upon lot or chance," in the regulation of broadcasting by the FCC to mean anything different from the identical phrase used in the mail statutes. In both cases Congress was attempting to limit the dissemination of information relating to lotteries, and not to other forms of gambling.

Congress consistently used the word "lottery" despite the fact that there are many other forms of gambling and games of chance, including forms that are clearly not lotteries. It is clear through the other laws Congress has passed that it recognizes that lotteries are simply one form of gambling. If Congress had meant to prohibit the broadcasting of information relating to all forms of gambling and not just lotteries it could have easily done so; Congress used the appropriate language in other statutes. Title 18 Section 1082(a) of the United States Code makes it unlawful for an American citizen to operate "any *gambling* establishment on any *gambling* ship" or "to conduct or deal any *gambling game*" on an American vessel. A number of other federal statutes speak of "*gambling devices*," 18 U.S.C. Section 1953, "*bets or wagers*," 18 U.S.C. Section 1084, and "any business enterprise involving *gambling*." 18 U.S.C. Section 1952. In no other statute and with no other regulation is the term "lottery" presumed to mean "all forms of gambling."

Other forms of gambling were legal at the time the anti-lottery statutes were enacted,

and under the rules of statutory construction the courts must find the intent of Congress was to keep legal those games not included in the definition of the specific term "lottery." Draw poker, for example, has been legal in California since at least 1860. Poker and other gambling games were legal in the New Mexico and Arizona territories until 1908, when the territories outlawed gambling in their drives to become states. In Nevada casino gambling was made legal in 1869 and not outlawed until 1909, long after Congress passed the first anti-lottery statutes. Poker was also legal in Nevada, Colorado, Oregon and Washington at the time Congress was worried about "lotteries." It is interesting to note that all of the states that allowed (and still allow) poker to be played have some constitutional prohibitions on lotteries.

The United States Supreme Court has consistently limited the definition of "lottery" and acknowledges that "lottery" is not equivalent to "gambling." The Supreme Court in *Stone v. Mississippi*, 101 U.S. 814 (1880), reaffirmed a definition that sounds strange today, but is still the law. A lottery is defined "a widespread pestilence." If a form of gambling isn't a widespread pestilence it isn't a lottery.

> "Experience has shown that the common forms of gambling are comparatively innocuous when placed in contrast with the wide-spread pestilence of lotteries. The former are confined to a few persons and places, but the latter infests the whole community; it enters every dwelling; it reaches every class; it preys upon the hard earnings of the poor; and it plunders the ignorant and simple." 101 U.S. 814, 25 L. Ed. 1079, 1080, quoting *Phalen v. Virginia*, 8 How. 163, 168, 12 L. Ed. 1030 (1849).

Stone is particularly important because it was decided during the years of debate in Congress on the anti-lottery bills. Congress knew, when it passed the anti-lottery statutes, that the Supreme Court had construed the word lottery to exclude common forms of gambling. As *Stone* reminds us, Congress knew what lotteries were because the federal government had run lotteries itself.

The courts have caused some unnecessary confusion by defining a lottery in terms of its three elements: consideration (payment), chance and prize. Unfortunately, these same three elements can be said to apply to all forms of gambling. In practice, no one has had any trouble determining whether a particular game is a lottery, except for the FCC. The United States Supreme Court has focused on one major distinction: a lottery is a "widespread pestilence" while other common forms of gambling are limited in time, place and types of players. Some state supreme courts have adopted this distinction.

The Supreme Court of Oregon rejected the "widespread pestilence" definition as being too restrictive. "It is the character of the gambling plan or scheme which determines whether it constitutes a lottery, rather than its widespread evil consequences

or the number of persons who participate therein." *State v. Coats*, 158 Or. 122, 74 P.2d 1102, 1105 (1938). It is important to note that even under this test there is a distinction drawn between lotteries and card games, such as poker.

> "If any substantial degree of skill or judgment is involved, it is not a lottery. Of course, all forms of gambling involved prize, chance, and consideration, but not all forms of gaming are lotteries. A lottery is a scheme or plan, as distinguished from a game where some substantial element of skill or judgment is involved. Poker, when played for money, is a gambling game, but, since it involves a substantial amount of skill and judgment, it cannot reasonably be contended that it is a lottery." 74 P.2d at 1106.

I have conducted an extensive computer and law library search and have not found a single case upholding the claim that any card game falls within any local, state or federal anti-lottery law. Poker, for example, has been prohibited as a "game of chance," but never as a "lottery, gift enterprise, or similar scheme" or any other such language. Although there are no cases defining poker within anti-lottery laws, there are numerous cases holding that poker and other gambling games are not subject to the restrictions on lotteries. As the Colorado Supreme Court put it:

> "In Colorado a 'lottery' or 'gift enterprise' cannot be authorized by law. However, there is no prohibition in our Constitution which prevents the legislature, or the people, from authorizing certain forms of gambling. It unquestionably is true that all lotteries and gift enterprises are forms of gambling, but it does not follow that all gambling is a 'lottery' or 'gift enterprise,' as those terms are defined in law. No one would contend that a game of poker, in which money is bet upon the relative value of the cards held by the participants, constitutes a lottery, but it most certainly is a form of gambling." *Ginsberg v. Centennial Turf Club*, 126 Colo. 471, 251 P.2d 926, 929 (1952).

The Colorado Supreme Court has never talked to the staff of the Federal Communications Commission; the FCC believes that poker is a lottery.

It may seem silly to have to prove that a card game like poker is not a lottery, but you can never take anything for granted with the law. After all, the FCC, the government agency charged with enforcing the law, claims that every casino game *is* a lottery. So the burden is on us to analyze the two forms of gambling and find the elements of each that are different.

A major difference between a lottery and a casino game is the requirement in the casino that the player remain physically present to play and win. With a lottery or similar scheme a player can buy a ticket and leave, the drawing will take place whether or not any individual ticket holder is present. A card or dice game requires that the

player participate in all stages of the game; there can be no play or outcome without the active participation of the players.

Similarly, in criminal law a person who "aids and abets" another is as guilty as the actual perpetrator of the crime. A poker player might be found guilty of the crime of running an illegal game; however, the purchaser of a lottery ticket cannot be held liable for the acts of the lottery organizers.

The amount of control a player has on the outcome distinguishes poker and other games from lotteries. In a card game the player can make choices based on factors within the player's own control: his knowledge of statistics, strategy and psychology come into play. The player's actions, in turn, affect other players. A card player can directly affect the outcome of any individual game, and can certainly affect the outcome of an extended session of a number of games. In a lottery the player has no control, other than to decide which random numbers to buy. The player's decision to buy a lottery ticket or not, or to buy thousands of dollars worth of tickets, has no effect on the actions of other players or on the eventual outcome.

In a lottery players pay a valuable consideration to play. The payments of all of the players are pooled together. This pool becomes the source of the prizes, which are distributed by lot. In a card game players play against other players. There is no drawing of prizes, and the winning is not determined by a drawing of lots. Bookmakers have beaten the anti-lottery laws by proving that the bettors are betting against the bookie; there is no prize decided by drawing lots.

In the eyes of the law, a person who buys a lottery tickets creates a contract. Whether the contract is enforceable will depend on local law; however, the United States Supreme Court has defined what is and is not such a contract under the federal anti-lottery statutes. "A ticket, of course, is a thing which is the holder's means of making good his rights. The essence of it is that it is in the hands of the other party to the contract with the lottery as a document of title." *Francis v. U.S.*, 188 U.S. 375 (1903); *Lottery Case*, 188 U.S. 321 (1903).

There is nothing that corresponds in a casino game to this contract. Lotteries sell chances to win a relatively large amount for a relatively small consideration. The ratio of price, prize and chance are set and cannot be changed by the player. Card games do not have set ratios, prices or prizes. Large wagers are often made to win a relatively small amount. While a lottery player is free to buy as many tickets as he wants at a set price a card player is limited by both the rules of the game and the willingness of other players to match the wager.

The amount of luck or skill involved in any game has always been important in determining whether or not the game is a form of gambling. Some courts have gone further and looked at the amount of skill and luck to determine whether the game was a lottery. The English rule, the "pure chance" doctrine, states that a lottery involves pure chance and that any element of skill will take the game out of the pro-

hibition on lotteries. This doctrine has been accepted by a federal court of appeals interpreting the federal anti-lottery language. "Gambling schemes where winning depends on skill or judgment are not like a lottery in which success is determined by pure chance and is thus specially attractive to the inexperienced and the ignorant." *Boasberg v. U.S.*, 60 F.2d 185, 186 (5th Cir. 1932).

The FCC itself has ruled that betting on horse races is not a lottery because it involves skill. It is inconceivable that a fact finder would say that betting on a horse race involves skill but playing poker or blackjack does not. As one judge put it:

> "The State argues that poker is not a game of skill but is a game of pure chance or luck. This allegation is a canard. Anyone familiar with even the barest rudiments of the game knows better. Pure luck? Send a neophyte player to a Saturday night poker game with seasoned players and he will leave his clothes behind and walk home in a barrel. Pure luck? This is true of bingo or lottery. But it cannot be said of poker. The court should take judicial notice that poker is a game of skill. It cannot be gainsaid, of course, that there is an element of luck in poker. Of course there is. There is an element of luck in everything in life. Even the prosecution of a lawsuit contains an element of luck. But everything that contains an element of luck is not gambling." *People v. Mitchell*, 111 Ill.App.3d 1026, 444 N.E.2d 1153, 1157 (Heiple, J., dissenting).

Criminal laws, those laws that are "penal" because they can lead to punishment, are traditionally strictly construed; this means if there is any doubt as to the meaning of a criminal statute the law is to be interpreted in as narrow a way as possible. The United States Supreme Court has ruled that the federal statute dealing with the broadcasting of lottery information and the corresponding regulations of the FCC must be strictly construed.

Clearly not all forms of gambling are "lotteries." In addition, there is a second major weakness to the FCC's position prohibiting legal gambling games from advertising: if the anti-lottery laws apply to licensed casinos they are unconstitutional.

Statutes and regulations must be construed in such a way as to avoid any conflicts with the United States Constitution. The present interpretation of the anti-lottery statutes and regulations leads to a number of constitutional problems.

The federal anti-lottery statutes are not just prohibitions on advertising. They prohibit "any advertisement of *or information concerning* any lottery . . . " 18 U.S.C. Section 1304. If a licensed casino falls within the definition of a lottery a broadcaster could not run a commercial, or carry news about casino's opening or closing, or even carry a political debate as to whether the legal game should be outlawed. Such a broad prohibition is unconstitutional under any definition of free speech.

We are not dealing with what are called "time, place and manner regulations," preventing X-rated TV shows from being broadcast at 4 p.m. when the kiddies can

see them. The federal laws on lotteries are a complete ban of advertising and other information over the broadcast media and through the mails. Under the interpretation of federal law by the FCC a licensed casino would be the only form of legal enterprise in the United States that would be subject to complete censorship.

Advertisements for a legal game are commercial speech, a form of expression that is given partial, although not complete, protection under the First Amendment. The states and federal government have the right to prohibit the dissemination of information promoting illegal activities, such as illegal gambling. Government cannot completely prohibit the dissemination of information relating to a legal activity such as a licensed game.

The First Amendment of the United States Constitution guarantees "Congress shall make no law . . . abridging the freedom of speech, or of the press." In a series of cases beginning in 1975 the U.S. Supreme Court stated that speech that was designed solely as an advertisement was entitled to at least some of the protections of the First Amendment.

The Supreme Court has given the reasons it expanded the protections of the First Amendment to cover commercial speech. The court "rejected the 'highly paternalistic' view that government has complete power to suppress or regulate commercial speech. People will perceive their own best interests if only they are well enough informed, and the best means to that end is to open the channels of communication, rather than to close them." *Central Hudson Gas v. Public Service Comm'n.* 447 U.S. 557, 562 (1980).

The Supreme Court's latest word (apparently meant to be definitive) is a four-part test set forth in *Hudson* for measuring whether a government regulation of commercial speech is constitutional, 447 U.S. at 564. The test requires the following analysis:

1) Is the subject matter lawful and not misleading;
2) Is the asserted governmental interest substantial;
3) Does the regulation directly advance the governmental interest; and,
4) Is the regulation no more extensive than necessary to serve that interest.

It is beyond the scope of this book to go into these tests for commercial free speech in detail. But as a quick glance will indicate, it would be very hard to prove a case for the complete censorship of a legal game. After all, almost all states have chosen to make one or more forms of legal gambling available and more than 20 states spend millions of dollars each year promoting their state lotteries. It is difficult to see what interest the federal government has in preventing a licensed casino from advertising on local radio stations in Nevada. Congress itself has amended the anti-lottery statutes to allow state lotteries to advertise. The Supreme Court has stated that the government's interest in restricting information about an activity that is legal is minimal at best.

The Supreme Court has decided a case in which a government attempted to com-

pletely eliminate a form of commercial speech, *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748 (1976). A Virginia statute prohibited pharmacists from advertising prices for prescription drugs. The Court ruled that such a blanket prohibition on a form of legal commerce violates the First Amendment. The Court summed up its feelings in the last paragraph of the opinion:

> "What is at issue is whether a State may completely suppress the dissemination of concededly truthful information about entirely lawful activity, fearful of that information's effect upon its disseminators and its recipients. Reserving other questions, we conclude that the answer to this one is in the negative." 425 U.S. at 773.

The Constitution also prohibits governmental action that denies a citizen equal protection of the laws or takes their property without due process. Of all legal businesses, only legal gambling has been prohibited from telling the public about its goods and services. The discrimination is more blatant in those states that advertise their own state lotteries, which are exempt by statute. The current interpretation by the FCC staff allows horse and dog racing and tournaments to advertise. Businesses run giveaway drawings that are clearly lotteries under any definition. The law should not allow one competitor to promote its business while making it a crime for other competitors to do exactly the same thing.

It also appears likely that the FCC interpretations would be struck down as being arbitrary and capricious. The FCC staff previously declared poker a game of skill and allowed legal poker games to advertise; a few years later the FCC staff changed its mind, for no reason.

There are very few federal, state or other government prohibitions on advertising legal gambling. Most of the statutes that do exist are aimed specifically at lotteries, and even those are of questionable validity given the recent expansion of constitutional protection for commercial free speech. There is one great fly in the ointment: the FCC. So long as the anti-lottery statutes remain on the books, or the FCC chooses to believe that "lottery" includes every form of gambling, radio and television stations will be fearful of running gambling commercials. Legal gambling will remain the only legal business in the United States that cannot advertise.

What can be done?

There are a number of options, all of which entail some risk and require some expense.

The first would be to change the laws, amend the statutes so that only illegal lotteries are prevented from advertising. Three bills introduced in Congress last year attempted to do just that. Senator Laxalt and Representative Reid of Nevada introduced legislation to amend the anti-lottery statutes to make explicit that the prohibition on advertising does not apply to lotteries that are legal under the laws of a state. A separate

bill by Representative Sensenbrenner of Wisconsin would add a new section to the anti-lottery statutes, allowing lotteries run by nonprofit organizations to advertise.

The bills are somewhat disturbing because they seem to concede to the FCC's argument that all forms of gambling are lotteries. The bill exempting only charitable lotteries would obviously not solve the problem. However, the other two bills would get the job done: legal gambling would not have to fight for the right to advertise if these bills were passed. Unfortunately, legal gambling first has to fight to get the bills passed.

The bills found considerable support from the legal gaming community, including those areas, such as horse racing, that are exempt under the FCC's own rulings. Also in support were Congressmen who believe in free speech and freedom of the press. The most interesting support came from the Department of Justice, which doubted the constitutionality of the present anti-lottery laws. Even the FCC said it wished it did not have this burden on its back.

And yet, Representative Reid's bill was defeated by the Administrative Law Subcommittee of the House Judiciary Committee on June 28, 1984; and, Senator Laxalt's bill, although approved by the Criminal Law Subcommittee and the Judiciary Committee of the Senate, does not appear headed for early approval by the full Senate. Religious conservatives are blocking what they see as an expansion of gambling and all its accompanying evils.

The fight in Congress is certainly not over; but, it will be a long battle fought through various committees and subcommittees and eventually both houses, and on to the President. The bills would also simply exempt legal games from the federal laws; they would not guarantee that the various states will not act to prohibit advertising.

A second route to get the law changed would be to get the FCC to see the error of its ways. A request for a declaratory ruling can be made. Given the statutory language preventing lottery ads from being broadcast, the best a casino could hope for is a ruling that its non-lottery games, like poker, could advertise. The FCC cannot refuse to enforce a statute passed by Congress, even if it wanted to. A ruling by the FCC could set up a court challenge, which is the third route open to legal gambling.

Even without a declaratory ruling by the FCC legal gambling may ultimately have to file suit in court. The test case should be carefully chosen. A lawsuit over the right to advertise blackjack, for example, might result in a ruling that the anti-lottery statutes simply do not apply, because blackjack is not a lottery. Only blackjack would then be exempt, the laws and FCC regulations would remain on the books.

The perfect test case would be one involving a small, local radio station in Nevada, broadcasting a tasteful, honest ad for keno at two o'clock in the morning. The station will be a party to the lawsuit, since it faces sanctions from the FCC for running the

commercial. Other possible parties include the casino that wants to advertise and possibly even an individual gambler, who wants to know what games are available. The station should be heard only in Nevada (possibly an FM station will be necessary) so that the federal government will have to justify restricting the flow of information within a state that has chosen to make gambling legal.

The game advertised should be keno because if keno is not a form of lottery then no game played in a casino is a lottery, which would be a victory in itself.

Lastly, the ad must be within the guidelines of the Nevada regulations, must be non-offensive, and must be broadcast at a time that small children will not be inadvertently exposed. Running the ad at two o'clock in the afternoon would be riskier, since the court might decide there is a need for restrictions on broadcasting to protect children. On the other hand, the early morning commercial forces the court to face the complete prohibition on broadcasting laid down in the statute and FCC regulations.

Who will fight the test case? It will take a number of years and at least $100,000 to fight a case like this all the way to the United States Supreme Court. All the time there remains the small, but real worry that the radio station's license might be in jeopardy.

Legalized gambling operations have always been extremely reluctant to rock the boat, since they can theoretically be outlawed with a flick of a legislative pen. Who will fight the test case? Whether anyone is willing to come forward remains to be seen.

6

The Common Law of Gambling

To understand the law of gambling in the United States in the 1980s and 1990s you have to understand what the law was in England in the Middle Ages. Much of current American law developed between the time of the Battle of Hastings in 1066 and our split with the mother country during the American Revolution. This is true of most areas of the law, but none more than gambling.

Our views of what the law is have changed dramatically over the past few hundred years. In medieval England and even into the 19th Century legal philosophers believed that "The Law" actually existed somewhere, like a great book floating in the sky. All we had to do was think things through and eventually we would all know "The Law." This legal philosophy had a religious tinge to it. Once we all knew "The Law" there would be no further need for courts or law makers; it would be sort of a lawyers' counterpoint to the Messianic Age.

Since "The Law" could be found through pure reasoning, no one was entirely bound by anything that had gone before. Prior legal decisions, what we call precedents, were considered to be very good indicators of what "The Law" is, but were not binding. If a judge thought previous judges were incorrect in their reasoning he could make a ruling completely in opposition to what had gone before. However, that did not happen very often, partly because the judge would have to explain his own reasoning on why his vision of "The Law" was true and his predecessors false.

Over the centuries a great body of legal doctrines developed, which we today call the common law. Parliament and judges added to the laws as new legal questions arose.

Although our legal philosophy has changed we still find the common law not only extremely useful, but extremely powerful. Most legal issues involving gambling law, or almost anything else that goes on in the United States today, are decided on the basis of common law.

Some things have changed, at least in theory. Judges today feel themselves bound

by precedent, not because we believe in "The Law," floating in the air, but because it is considered unfair to change a legal decision that everyone has been relying upon. However, it is easy for a judge to distinguish between two cases, finding that the facts before him are sufficiently different from the older cases that he is not bound by precedent. In fact, in practice, it is fairly easy to find both precedents and legal theories that will support almost any outcome that a lawyer or judge wishes to make.

Courts are also more free in deciding that the common law was simply wrong, or was right for its time but wrong for post-industrial America. One of the criticisms directed at Rose Bird, Chief Justice of the California Supreme Court, is her tendency to change the common law to fit her personal ideological beliefs. In a typical recent case the Bird Court held that a company could be liable for allowing its truck to be stolen. The thief accidentally ran over someone; in the Court's view of social engineering, the deep-pocket company should pay.

Another big change has been the increased role of the legislature. In ancient times a legislature like Parliament could change the law only with the greatest of effort, after all, it was not up to Man to change "The Law." Prior to 1700 it was generally accepted that a legislature could not modify the basic principles of the common law. Today, any legislature can pass a statute and modify the common law by a simple majority vote. This is done often in direct response to a ruling by a judge that is unpopular.

The common law is still developing today, from both court decisions and statutes passed by legislatures. Each state is free to experiment and develop its common law as it sees fit, within the limits of our constitutional government. One state, like New Jersey, may say that gambling debts are collectible; a neighboring state, like Virginia, may say just the opposite. The only way to know the common law in any particular case is to study the statutes and court decisions of the jurisdiction in which the case is being heard.

It is possible to describe the common law of gambling, at least in general terms. If you know what the general common law is you will have some idea of the law of your own state. Most states still have the common law, unchanged from what we call the date of reception. When a state creates its state constitution it includes a clause stating that it has "received" the common law as of a certain date, usually the year it became a state. Many state legislatures also become busy passing laws that codify, that is put into the statute books, the common law. Because the common law has proved itself over the years and because it usually takes a positive act by the highest court of the state or the state legislature to get the law changed most states have kept at least the general concepts of the common law unchanged.

One interesting little footnote to all this history. What we Americans thought was the common law of England, wasn't necessarily so. Lawyers during colonial times could not afford to have or carry around sets of all the cases and acts of Parliament,

even if they had been available. Instead, most colonial lawyers relied upon a single volume summary of the common law, Blackstone's *Commentaries*. The book became so popular and widespread in its usage that lawyers in America for over a hundred years after the Revolution relied upon the *Commentaries* to tell them what was the common law. The fact that Blackstone had been wrong in some of his summaries was of little consequence; pretty soon, through court decisions, his book became the common law.

So what is the common law of gambling?

In the earliest days of the common law all games were legal, and a loser had to pay off his debts. Under the common law, however, the courts could close down as a public nuisance any activity that ran the risk of a breach of the peace or of public morals.

The law is often a good reflection of the society in which it is formed. The first English statute to directly affect gambling arose from the needs of the time. King Richard II in 1388 had a statute passed directing all laborers and serving men to secure bows and arrows and to abandon the pursuit of "tennis, football, coits, dice, casting of stone kaileg, and other such importune games."

Telling working stiffs to knock off the dice and practice archery is not a mere relic of the past. The laws against gambling grew because the games, and in particular the rowdy houses where the games were played, were seen as sapping the strength of the country, both in the colonies and Great Britain. Preparation for war was the major focus of the early statutes. Later laws were concerned with laborers missing work and causing even more poverty in the early days of the Industrial Revolution.

Of course, preparation for war remains important. Louisiana still enforces wagers and gambling contracts that promote horse racing, shooting matches, and foot races. These activities are not even considered gambling because they are "skills of war," and considered vital to military preparedness.

Horse racing, besides being the "Sport of Kings," was supposed to "improve the breed," and was thus encouraged, or at least tolerated. Before the train or automobile, society was built around the working horse. Horses run in races were not bred specially for running, and races were more tests of endurance than speed. On the other hand "gaming," gambling games which were played indoors in taverns, was seen as promoting idleness and violated the rising Puritan ethic. Gaming was fought against with every weapon the government had at its disposal.

The intent of the common law, to ban rowdy houses while encouraging the skills of war, was carried over into the United States. The first race track was set up in New York in 1666. Horse racing was a privilege reserved to gentlemen; in fact, prior to the American Revolution only gentlemen could race horses in the Commonwealth of Virginia. (After the Revolution anyone could race horses). Feelings against gambling games, on the other hand, ran so strong that the Massachusetts Bay Colony

outlawed the possession of cards, dice, or gaming tables, even in private homes.

The professional bookmaker did not appear until the 1870s. Bets were then recorded in books by hand. The invention of the telephone, telegraph and ticker tape freed the bettors, and the bookies, from having to be physically present at the track. "Poolrooms," illegal off-track betting parlors, opened in every major city to take bets from across the nation.

The horseowners had occasionally pooled their money, with the winner of the race winning the pool. The average spectators were left to make bets with whoever would bet against them. Bookies operated by taking those bets. The bookie arranged his odds so that he could not lose, if the players bet equal amounts on the various horses in a race. Since the bets did not often equalize out, the bookies would often limit the amount that could be bet on a particular horse. Another invention, the parimutuel machine, introduced into America in the 1870s, allowed the players to pool their bets and bet on any horse they wished.

The expanded interest in horse racing lead to a wave of reform. State legislatures began passing criminal laws prohibiting bookmaking since it was not illegal under the common law, which saw nothing wrong in horse races.

After King Richard II broke ground with the first anti-gambling law, prohibitions grew quickly over the next 150 years. Henry VIII brought all the gambling statutes together in 1541. In addition he made it unlawful to maintain a house or place of dicing, table or carding, or other gambling. This was a strong statement against what was termed common gambling houses, which we would today call casinos. This statute, which has never been overturned, became an important part of the common law, and is still the law today, over 440 years later.

Technically, Nevada casinos are not 100% lawful enterprises the way barber shops or food stores are. Rather, the casino owners and operators have only been given a license that protects them from criminal penalties for gambling. Even when the state shares in the profit through taxes and regulates the games, all the casino has is a license. As the Supreme Court of Nevada put it, "[T]he licensing of gambling is merely permissive, and serves to give immunity from criminal prosecution and nothing more." *West Indies, Inc. v. First Nat. Bank of Nevada*, 67 Nev. 13, 214 P.2d 144, 149 (1950).

A case was decided in 1603 that is still of interest to gamblers. The court held that the common law did not prohibit the playing of games, although immoderate play could be unlawful under the common law. Most importantly, the decision prevents a court from defining what is an illegal game; only a statute passed by the legislature can state which games are prohibited and which are allowed. If the legislature does not include a particular game in the prohibited list the game is legal under the common law.

Forcing the legislature to decide on a case-by-case basis what games are illegal

has caused untold headaches, usually for law enforcement, for the last four centuries. The gamesters are much more inventive than the lawmakers; as soon as one game has been outlawed the gaming operators come up with small variations in the rules and a new name for a similar game. The whole idea is made a further exercise in futility given the natural variations that exist in the games from town to town and region to region. At a time when it was considered vulgar to even speak of gaming in public, let alone publish rule books, it became impossible for the lawmakers to cover all the gambling games they wanted to outlaw.

The problem still exists today. The California Penal Code lists 12 specific games that are illegal in the state, most of which have not been played anywhere in the world for over 100 years. In 1885 the State Legislature added "stud-horse poker" to the list, and no one alive today knows what that game is. It was probably 5 card stud, and when that game was outlawed the poker rooms switched to 4 card stud. The Legislature was then forced to outlaw 4 card stud. For some reason, they never chose to outlaw draw poker. Everyone agrees that whatever stud-horse poker is, draw poker is still legal in California.

It has only been in the last 20 or 30 years that state legislatures began to rewrite their anti-gambling laws to gambling games in general, rather than try and list the specific games. This is not as easy as it sounds. Try and write a statute that will outlaw craps and blackjack but not Monopoly and bridge; and keep poker legal only when it is played in a friendly game.

In 1710 lotteries were declared common nuisances. Lotteries are a third form of gambling, different from both horse racing and gambling games. Until the advent of the professional bookmaker, betting on a horse race was a fairly private affair, usually between the wealthy owners and only occasionally the spectators. Gambling games require the players to go to some special place, like a tavern, and participate in the play. Lotteries, on the other hand, are both public and require no player participation. A lottery, as the Supreme Court reminds us, is a "pestilence . . . infests the whole community; it enters every dwelling; it reaches every class . . . " *Stone v. Mississippi*, 101 U.S. 814, 25 L.Ed. 1079, 1080 (1880).

A lottery craze swept the United States from the Colonial period until near the Civil War. However, there were a number of scandals, and the states reacted by locking in, or so they thought, strong anti-lottery laws. Lotteries were often the only form of gambling prohibited by the constitutions of the various states.

Other laws followed the prohibitions of Kings Richard II and Henry VIII, but the most important for present-day gamblers was the Statute of Anne, which was enacted to enforce all the other anti-gambling statutes.

The Statute of Anne was the last major addition to the common law of gambling, and is unquestionably the most important development in English gambling law prior to the American Revolution. In the following half century a few more specific games

were added to the list of outlawed games, including pharaoh (faro), basset, all games involving dice except backgammon, and roulette. A half-hearted effort was made to suppress gaming houses in a statute with a title that was typical of the age: "An Act for the better preventing Thefts and Robberies, and for regulating Places of publick Entertainment, and punishing Persons Keeping disorderly Houses." 25 Geo. II, c. 36, Section 5 (1752). But it was the Statute of Anne that set the standard principles of gambling law in place for the next three centuries.

The law on gambling debts, for example, has been fairly well settled since Queen Anne of England signed the Statute of Anne. So is the question of whether a gambling contract is enforceable. Crooked gamblers became subject to criminal and civil penalties. Professional gamblers were subject to special sanctions.

This 275 year old English statute is of great importance to gamblers in modern America because the Statute of Anne is part of the common law of every state. The Nevada Supreme Court, for example, ruled in 1950 that "Those portions of the Statute of Anne are in force which are applicable to our conditions and not in conflict with statutory law." *West Indies, Inc. v. First Nat. Bank of Nevada*, 67 Nev. 13, 214 P.2d 144, 152 (1950).

State legislators can change the common law by passing an Act signed by the Governor, but very few states have so acted. In fact, it was only within the last two years that the Nevada Legislature repealed that part of the Statute of Anne that made gambling debts uncollectible.

The Statute of Anne has a number of interesting provisions, all of which could conceivably be the law of your state:

1) Anyone who loses while gambling can get his money back, if the loser sues the winner within three months. If the loser does not want to sue, anyone else can sue the winner and get three times the amount of the original loss. (This is in fact still the law in such states as Massachusetts for illegal bets, but imagine going up to a Las Vegas pit boss and asking for your money back.)

2) Any person winning by fraud is subject to corporal punishment, which in old England meant flogging, imprisonment or death.

3) Gambling is legal only within His Majesty's Royal Places.

4) "All notes, bills, bonds, judgments, mortgages, or other securities or conveyances . . . given . . . for any money, or other valuable thing whatsoever, won by gaming or playing at cards, dice, tables, tennis, bowls, or other game or games whatsoever, or by betting . . . or for repaying any money knowingly lent . . . shall be utterly void, frustrate, and of none effect to all intents and purposes whatsoever."

Wealth in England in 1710 was based on ownership of land and gambling was disrupting the country's society by causing large transfers out of the hands of the aristocracy. The Statute of Anne was passed to protect the landed gentry from the consequences of their own folly.

For over 200 years the Statute of Anne has been enthusiastically accepted by the courts of the United States. Gambling debts, in fact all contracts having anything to do with gambling, are not only void, not only illegal, but are treated as somehow unclean, and the courts will not sully their hands with even considering the merits of the claims. A gambling debt is treated exactly the same as a contract for prostitution; the courts will "leave the parties where it finds them" and will automatically dismiss every claim.

Thus the common law came to attack gambling on all levels. There were direct attacks on the games, the players, the operators, professional gamblers, fraudulent gamblers, and the places where the games were played. To the common law were added indirect attacks: losers could sue to get back their winnings, contracts that promoted gambling were unenforceable, securities used to pay gambling debts were void. And so the law has stood over the centuries.

The effect of the common law has been astonishing at times. There is nothing in these ancient cases and statutes that distinguishes between legal and illegal games. All illegal bets, from a debt owed to a bookie to a check written at a friendly poker game, are void and unenforceable. But so were legal bets under the Statute of Anne. If a player stopped payment on a check to a Nevada casino the casino could not use the court system to collect.

And since debts can run both ways, players who thought they were owed money by a casino were consistently thrown out of court. Gambling debts were simply not collectible, whether the claim was based on a player's marker or a winning bet at a licensed casino.

The common law remains the law of every state until it is changed. State legislatures have been reluctant to make any changes in gambling law; even if the law no longer makes sense there are few politicians who are willing to cast public votes for such things as making gambling debts collectible.

The result is a general confusion and conflict when one jurisdiction, such as New Jersey, does vote to change the common law. That part of the Statute of Anne making gambling debts uncollectible was repealed by the voters and legislators of New Jersey. So gambling debts are collectible in that state. Virginia has not chosen to repeal the Statute of Anne. Are casino debts, legal in New Jersey, collectible in a court in Virginia? One Virginia court said yes, another, no.

The law becomes even more self-contradictory, and subject to ridicule, when a state changes part of the common law. Nevada for 50 years made casino gambling legal but still refuses to repeal the Statute of Anne, except in bits and pieces. A casino can now sue a player but a player cannot sue a casino. Virginia allows charity bingo. But the Supreme Court of Virginia told a winner who had been stiffed that she was out of luck: the courts of the state are closed to gamblers.

Obviously, it is of great importance, even today, to know just what is, and what

is not "gambling." Unfortunately, the answer is not always as clear as it should be.

I mentioned in Chapter Three that I am involved in a long-term fight to bring Texas Hold 'em poker to California. When I told one of my fellow law professors about this controversy, he responded, "I thought all forms of gambling were illegal in California. I guess draw poker is a game of skill and stud poker is a game of luck." My colleague has been a practicing attorney, a consultant to some of the largest corporations in the world, and is now a professor of law at a distinguished, accredited law school. Yet, almost everything he said is dead wrong.

But I cannot be too hard on my colleague. Even lawyers who have some knowledge of the field, including the Attorney General's office, jump to conclusions too quickly when dealing with gambling law. It is safe to say that there is no field of law in the United States today that is as complex and outdated, and as little studied, as the law of gambling.

Even the name of the specialty is subject to dispute. Most attorneys who practice in the field say they are involved in "gaming law;" the professional group for practitioners is "The International Association of Gaming Attorneys." "Gaming" is the heading used by most of the legal encyclopedias. The legal encyclopedias developed their systems of headings and divisions of subject matter in the 19th century, these same encyclopedias used to list cases involving marijuana under the heading, "Poison."

But one encyclopedia has a completely separate listing for "Lotteries." And *Gaming Business* magazine had to change its name to *Gaming and Wagering Business*, since many of its subscribers insisted that they were not in the "gaming" business. Race tracks are particularly offended with being lumped in with either "gaming" or "gambling." The California State Lottery Commission has announced that as official policy the lottery is not gambling. The problem has gotten so bad that a recent trade show had to advertise itself as "The Second Annual Conference & Exposition for Gaming, Wagering & Lottery Executives." I am sure that some charity bingo operators would resist being included in any of these categories.

Technically, there are distinctions in the common law among gambling, gaming, lotteries, and wagers, and the distinctions have important differences in the eyes of the law. The entire field should properly be called "gambling," although it is understandable why the more genteel word "gaming" is used. How many lawyers would want to belong to an organization known as the "International Association of Gambling Attorneys"?

Gambling is as old as man, and certainly as old as the common law. Gambling is generally defined in terms of its three elements. Gambling, under the common law, is any activity in which:

1) a person pays something of value, called consideration;
2) the outcome is determined at least in part by chance; and,
3) the winnings are something of value.

Although the legal encyclopedias may call the entire field "gaming," that term is more properly limited to actual games requiring the player to put up some stake and to participate in the play of a game against other players or the house. "Gaming" can thus be seen as one special form of gambling.

Another special form of gambling is the "lottery." A lottery requires the players to put their money into a pool for the chance to win a prize. The prize is drawn by lots, hence the name.

"Betting" and "wagering" are words that can be used interchangeably. They should be applied only to those forms of gambling that are not gaming or lotteries. In the law they can be seen as a promise to give something of value upon the determination of an uncertain event, whether or not skill is involved. Betting on a horse race falls within wagering, but is not gaming, nor is it a lottery.

I personally think the terms "betting" and "wagering" are too imprecise to be of much use, particularly since it is almost impossible to talk about any form of gambling without using those words. You can say a player makes a bet at poker, a form of gaming, but you also bet money on the lottery. If the racetracks want to say they are in the parimutuel business and not the gambling business, on the theory that they do not bet against the punters, they certainly have the right to do so. And they are probably correct in the technical legal definitions of the words, even if no one will understand what the fuss is all about.

The differences between the various definitions can be quite significant under the law. For example, the California Constitution originally prohibited all forms of lotteries. Yet, poker has been legally played for money in poker rooms in the state for at least one hundred years. Poker is not a lottery, although it is certainly a game of mixed luck and skill. Poker is, in fact, gaming, a form of gambling, technically a gambling game.

To allow a state lottery, the Constitution of California had to be amended to specifically exempt the state lottery from the complete prohibition on lotteries. No one would dispute that a state lottery is a lottery, but what about horse racing? To allow parimutuel betting at the tracks the state Constitution had to be amended, again to specifically allow betting on the horses. Parimutuel betting was felt to be a form of lottery, not wagering. In any case, it is certainly a form of gambling.

The ultimate example is the state of Nevada. The Nevada Constitution explicitly prohibits lotteries. The ban is stated in clear, strong language. When the Nevada Legislature instituted casino gambling in 1931 it did not amend the Constitution. To this day Nevada has legal gaming, but does not have a legal lottery—casino games of chance, including slot machines and keno, are not lotteries, under Nevada state law, and are therefore legal.

The Nevada Supreme Court was faced with the question of whether slot machines were legal, given the constitutional ban on lotteries. The Court held that a lottery

is a "widespread pestilence." Since a slot machine is a device that must be located in a fixed spot it must not be a lottery. This narrow definition of what is a lottery may not hold up in other states, but it is the definition the United States Supreme Court has used without exception since 1849.

Unfortunately, the United States Supreme Court has also held that a lottery is any activity having consideration, chance and prize. I say this is unfortunate because this is also the definition of all forms of gambling. Every form of gambling requires consideration; that is, the payment of something of value. Every form of gambling requires that the outcome depend, at least in part, on chance. And every form of gambling requires that the winner receives something of value, a prize. But not all forms of gambling are lotteries, although all forms of lotteries are gambling. The card game of poker is not a lottery, nor is speculating on the stock exchange. Under the Supreme Court's definition such "legitimate" enterprises as farming would be considered a lottery.

The three elements of gambling, consideration, chance and prize, have been the subject of literally thousands of court cases. If even one of the elements can be disproved the activity is not gambling under the common law. In a criminal prosecution for gambling the state has the burden of proving beyond a reasonable doubt the existence of all three elements. A criminal defendant does not have to disprove anything; all he has to do to be found not guilty is to raise a reasonable doubt as to any one of the three elements. In a civil suit, such as a local government attempting to close down a game or a private party suing for a gambling debt, the burden is usually on the plaintiff, the party bringing the suit, to prove the existence of the three elements by a mere preponderance of the evidence, 50% plus one. If the jury cannot decide, the plaintiff loses.

Of the three elements the first, consideration, is the easiest to see. It is pretty clear that when a person bets money they are putting up something of value. But what about a postage stamp? Clearly twenty cents is twenty cents, whether it is in the form of two dimes or one stamp. For this reason mail-in sweepstakes, the "You May Already Be A Winner" type, are a form of gambling, specifically a lottery.

Some sweepstakes have argued that they are not lotteries because they do not get the stamp, the post office does. This argument will not fly; there is nothing in the common law definition of gambling that requires that the promoter take the consideration, only that the bettor put up something of value.

Some states, like Washington, have gone even further in defining "consideration." In a case involving a supermarket giveaway the Washington Supreme Court held that consideration was present so long as the player gives up anything of value, including his own time and effort, or the game promoter received anything of value, including increased patronage. The supermarket was prohibited from running its game because people were required to fill out cards, which took time, and the store had increased

its number of potential customers because they had to walk into the store to drop off the cards. Under that definition of consideration there would never be any store promotions, because the whole point is to try and get people into the store.

There is a line of cases, beginning with the Alabama Supreme Court in 1890, that holds there is no consideration if the ticketholders do not have to pay any money to the organizer of the game for a chance to win. During the 1930s and 1940s "bank nights" became popular, and a headache for the law. A theater would offer a free set of dishes or other prizes to be given to the winning ticket, drawn by lot. Players did not have to be physically present to win, although they had to be close by, and they did not have to pay and see the movie. Most people did pay the admission price, which was the purpose of the scheme. Most courts held these were not lotteries.

The United States Supreme Court has not gone as far as the bank night decisions; although, the Court has held that something more than a player's time and effort is needed to find consideration, at least under the federal anti-lottery laws. The Federal Communications Commission had tried to shut down radio and television giveaway programs, "Stop the Music" and others, where the home contestants are called to answer questions about what was being aired. The Court stated,

> "To be eligible for a prize on the 'give-away' programs involved here, not a single home contestant is required to purchase anything or pay an admission price or leave his home to visit the promoter's place of business; the only effort required for participation is listening. We believe that it would be stretching the statute to the breaking point to give it an interpretation that would make such programs a crime." *Federal Communications Comm'n. v. American Broadcasting Company,* 347 U.S. 284, 294 (1954).

Even under this definition television game shows are gambling because the contestants have to travel to a studio and expend great amounts of time and effort to participate in the game. The FCC has apparently interpreted the Supreme Court's decision in a broad way and will only close down a TV or radio show if the contestant is required to put up some money.

Usually it is not difficult to find there is consideration. Disneyland, to celebrate its 30th anniversary, offered prizes for the 30th, 300th, 3000th, etc., visitors, ranging from free tickets to new cars. At first Disneyland required anyone wishing to enter the contest to pay for admission into the park. This was a classic lottery: the only way you could win was to pay an admission charge (consideration), winning is entirely by chance, and the prizes are certainly things of value. It was not legal under the bank night cases because customers were required to pay for admission into the park in order to participate; in the bank night cases a contestant could still win without paying to see the movie. The fact that the customer's money also paid

for an admission into the park, getting something else of value besides a chance to win a prize, does not prevent this from being a lottery.

Disneyland almost immediately changed its advertisements to state that no purchase was necessary. Anyone who wanted to enter the contest need merely show up at the entrance to Disneyland and sign up. No one challenged these new rules; but under the law of such states as Washington this is still clearly a lottery. If you have ever been to Disneyland you know that you either have to pay to park or be willing to walk a long distance to get to the entrance. If time and effort count for consideration, Disneyland was still running a lottery. There is the additional fact that Disneyland attracted additional paying customers through this promotion. Again it is not significant in the eyes of the law that the consideration was expended only by one side (the potential customer) and did not necessarily result in a direct financial benefit to the other side (Disneyland).

Disneyland did not now violate the California law against lotteries because the California courts do not follow the line of cases finding consideration whenever there is effort or benefit; California courts follow the separate line of cases requiring the player to make a cash payment for there to be consideration.

McDonalds and other fast food restaurants often have contests with rub-off prize cards. If the restaurant requires you to buy something, or even to enter the store to pick up the card (under the Washington State ruling) it is an illegal lottery. Radio contests that require you to be the 10th caller are lotteries because listeners have to spend time, effort and money, the cost of the phone call. They may be allowed by the FCC under the federal anti-lottery laws but they would be declared illegal under the criminal laws of many states, if anybody bothered to prosecute them.

And, of course, there are those mailed promotions, like Publishers Clearinghouse, which even advertises over the air.

The reason sweepstakes are so widespread is simply that the government does not choose to bust them. Many are illegal under federal law as a lottery and should be subject to the same controls as casinos, which means, at present, banned from the mails and airwaves. They are also illegal under the laws of virtually every state. Some states do, in fact, prohibit them. That is why you will see notices like "Void in the State of Washington" on some of these commercial promotions.

The power of the large marketing corporations is shown through their flaunting of the criminal laws against gambling. Can you imagine a con man selling watered stock issuing a disclaimer, "Void where prohibited by law"? Even attempting or conspiring to commit a crime, like illegal gambling, is a crime.

The second element, chance, has caused the most problems in the courts. Part of the problem is that if every human activity is mixed skill and chance, the question is simply where do you draw the line. The two extremes can be seen in common games. Chess is considered entirely a game of skill because it is completely open;

roulette, on the other hand, is considered entirely a game of luck. However, if chess were really just a matter of skill, the most skillful player should always win. And the noted mathematician Dr. Edward O. Thorp showed that a skillful player can increase his chances of winning at roulette, even with an honest wheel, because the croupiers, being human, tend to spin the wheel with an identical amount of force, spin after spin.

Courts have devised a number of tests for distinguishing a game of skill from a game of chance, although the results are not always consistent. Both the facts and the law of the specific case become very important. In England any skill at all takes a game out of the prohibited lottery category. California outlaws slot machines if any chance enters into the payoff, but then states that devices that are predominantly skill are legal.

Guessing games may be either skill or luck, depending upon what you are asked to guess; the number of pennies in a glass of water may be determined by skill (unless the glass is too big) but no one could know in advance the exact number of votes cast for President. The courts have held that it is a lottery to distribute prizes to those holders of cigar bands making the nearest estimate of the number of cigars on which the government would collect taxes in a month. But it is not a lottery to award prizes based on the neatest solution to a puzzle.

The courts have had little trouble finding pyramid schemes illegal lotteries. Chain letters and the gold and silver circle schemes are typical pyramids. Each new person puts up some fixed sum, say $100, and tries to advance to higher levels by bringing in others, who in turn have to pay and bring in others, and so on. The many people at the bottom of the pyramid pay out, while only the few who reach the top receive anything back. Since the population of the Earth is limited the scheme has to eventually fail; in fact, it ends much quicker than that after the promoters, whose names are on the top, have skipped out and the people on the bottom find out there are a limited number of new suckers available. Since the entire scheme depends on chance to make it to the top before the pyramid comes tumbling down it has all of the characteristics of a lottery.

A more modern version of the pyramid is the franchising scheme. An investor pays $1000 to join, $500 to the person who sold him a distributorship and $500 to the top member of the club, seven tiers above. The investor now has to sell additional distributorships to get back his money through "finders fees" and to rise in the pyramid. Like chain mail letters, the whole scheme falls apart when no new investors can be found. It too is a lottery; getting money out depends entirely on chance.

I have developed from the cases the criteria the courts use for determining whether a game is one of skill or luck. Some of the major characteristics of a game of skill are as follows:

1) A skillful player can continue to play until he has won all that is at risk. In

all card games there is more or less an element of skill. The Oregon Supreme Court gave an example:

> "Take, for instance, the great American game of poker; we have no doubt, if a couple of gamblers sat down to play this game against a couple of ministers, who presumably do not indulge in it, that the ministers would soon be destitute of 'chips' and the gamblers' pile augment accordingly." *State v. Randall*, 256 P. 393, 394 (Or. 1927).

2) Skill can be learned from experience, from real or mock play. Play improves with experience. All the experience in the world cannot help a slot machine or lottery player.

3) Skill games require a knowledge of mathematics. This is particularly true of games played with cards and dice, but applies to almost all other games. Backgammon has been a consistently difficult game to categorize since a skillful player will win over time, but a lucky player may win in the shortrun.

4) Skill games require psychological skill. This is obviously limited to games involving play against human beings. A player must know how to read people and how to influence the actions of others. "When poker is played with cards and with competitors, it would be helpful to the player if he or she possessed a skill such as an ability to count cards or a knowledge of psychology." 66 Ops. Cal. Atty. Gen. 276 (1983). The Attorney General of California distinguished video poker machines, stating "a bluff or a poker face is not likely to change the outcome of a game when the opponent is a computer."

5) Player participation changes the result. The Ohio Legislature created separate statutory prohibitions on "games of chance" and "scheme of chance," explicitly including a lottery. The Ohio Supreme Court analyzed the difference in terms of the control, however nebulous, the participant has.

6) Skill can be learned from reading. In determining that the card game of bridge was a game of skill and not a game of chance the Supreme Court of California pointed to the large body of books and periodicals discussing strategy for playing the game. "The existence of such a large amount of literature designed to increase the player's skill is a persuasive indication that bridge is not predominantly a game of chance." *In re Allen*, 27 Cal.Rptr. 168, 53 Cal.2d 5, 377 P.2d 280 (1962).

7) The opinion of the community. Common sense tells us that poker requires skill. Someone who knows virtually nothing about the game might be willing to buy lottery tickets every day for a year, and no one would criticize him for his poor plays. But we would all think that same person was crazy if he took an identical amount of money and without knowing the game played against a professional poker player.

The last element, prize, has not been of much trouble to the courts. If the prize is not worth winning the game soon ceases to attract customers. The only real con-

troversy has been in the field of "free replays." If a gambling device operator pays out in coins he is clearly giving something of value and will be busted for having illegal slot machines. But what if he gives free replays instead? True amusement machines, "Space Invaders" and the like, may give free replays, but nobody would say they are gambling devices. Or are they? That is our next case study.

7

Slot Machines, Video Poker and Video Lotteries vs the Law

Slot machines have come a long way since Charles Fey invented the first nickel three-reeler in a small machine shop in San Francisco in 1895. Today there are still three-reelers, but there are also machines with four, five, six and more reels; machines with flashing electronic displays for progressive jackpots; machines that link together for bigger payouts; machines that read the reels from left to right, right to left and from one corner to another; and machines that take everything from pennies (extremely rare) to dollar bills and solid silver $25.00 game tokens. There are slot machines that have eliminated the handle, requiring only the pressing of a button to set the wheels spinning. Some slot machines don't even have slots; the number of times a player can pull the handle (or press the button) is displayed as replays in a window of the machine.

Charles Fey, if he were alive today, would recognize all of these machines as refinements of his invention. Fey's original nickel slot machine, which he named the Liberty Bell, was startlingly similar to the mechanical slots of today: the machine was only slightly smaller, did not have a jackpot payout, and carried only ten pictures on each of its three wheels, but it was otherwise identical. Fey, by the way, chose pictures of fruits, bars and bells because many gamblers of his time were illiterate.

The slot machines of today with their spinning reels, whether real reels or video images of reels, are also identical in the eyes of the law. But what about the slot machines that are not quite like the others?

The casinos of the 1980s offer a wide variety of mechanical devices for the gambler, some of which might surprise Mr. Fey. There are keno machines with video screens and light pencils, and others with spinning wheels and flying numbered balls; there are video and mechanical card games in which the gambler can play head-on blackjack and poker against the machine; and there are even more exotic inventions. My

personal favorite is the horse race machine. The old version had little mechanical horses that ran around a track to determine the winner, the newest models feature a video screen which plays tapes of actual races. The odds for each horse and its name and number are given. All you have to do is pick the horse you think will win, drop in a quarter and watch the replay, complete with announcer (who is usually listed in the credits, just like in a movie). Of course it is very embarrassing to start shouting for your horse to win in a posh casino, but it does give you a lot of entertainment for 25 cents.

The latest inventions, currently undergoing the licensing process, are a credit card slot machine and a video craps game that is almost beyond belief. The credit card slot would allow players to buy special cards from the slot cashier and record their winnings and losses electronically on the card itself. When a player wins, the machine plays the pre-recorded sound of coins dropping into a metal basin, since the machine cannot pay out in coins. The manufacturers and casinos hope these will catch on because the major mechanical problem with slot machines is the handling of coins.

It is possible the credit card slots will prove popular, at least with one select group of players. There are now slot machine high rollers, who travel to Atlantic City or Las Vegas with $5000—to play the slots. They would probably enjoy the extra privacy and convenience of buying a credit card rather than having to get change all the time. But I doubt the average player will want to give up her coins.

The video craps is the first of a new generation of slot machines. Invented by Status Game Corporation the machine combines laser disc technology with a video screen and computer. The result is a crap game on a video screen with all of the sights and sounds of the real game, including interacting with the player. I played the machine at the International Gaming Business Exposition in February 1985 and it was the first time I really understood the term "future shock." I put a token into the slot, after the dealer on the screen became impatient, pressed the "Roll" button and played craps with a group of people for about ten minutes, only I was the only one on this side of the screen.

The casinos are not the only places where a player can find the new styled slot machines. Many states have machines for issuance of lottery tickets, and there is a movement across the country to go to instant lottery winners on electronic machines.

If you wanted to bet on a growth area in the field of legal gambling put your money on video lotteries. Given the inevitable decline in lottery revenue many states are looking to the video machines to make up for lost sales. Nebraska had them already and Illinois is operating them on a trial basis.

The state of Illinois is running a six-month test, since extended to nine-months, placing 300 electronic video lottery machines in taverns. The coin machines allow a player to choose a three number combination and will have immediate cash payouts of up to $600; bigger winners will have to wait for their money, to avoid placing

too big a burden on the tavern owners. If the test is successful and these machines spread nationwide, a player would be able to walk into a drugstore or supermarket, pay the machine with cash or possibly a cash transfer card, choose a number, and find out immediately if he has hit the jackpot.

The stakes are very high. There are currently about 80,000 slot machines in Nevada. It is estimated that if everything goes well with the test marketing, Illinois alone in the next four years could buy between 40,000 and 80,000 of these electronic video lottery machines.

The machines are obviously gambling, because they have the three elements of consideration, chance and prize. Are they lotteries? Not in the strictest, historical meaning, where a player could purchase a ticket almost anywhere (the "widespread pestilence" idea), the ticket was the representation of a contract between the player and the lottery operators, the ticket could be sold to another, and the player need not be present at the drawing. In fact, all instant winner prize cards are not lotteries in this traditional sense. But instant winners have become so much a part of the business of state lotteries that it would be almost impossible to attack these gimmicks as not being "true" lotteries at this late date.

Are these devices slot machines? A traditional, three reel slot machine determines the winner through the chance arrangement of symbols on the reels. A video lottery uses a computer to create a mini-pool of numbers for each play. The two would seem to be different, in theory. In practice, and in the eyes of the law, they are identical. Both are devices designed to take the player's money (consideration), determine the outcome by chance, and pay out something of value. If a video lottery is not a slot machine then neither are the video three reel machines you see throughout the casinos in Nevada and Atlantic City.

Even the paper instant winner cards are what are called in the law "paper slot machines." Gambling devices need not be mechanical; in the past the country was blanketed by pull-tabs and punchboards, which you bought at the local store in the hopes of winning a prize. Today's version of the pull-tab is the rub-off card, given out by fast-food restaurants, and paper bingo pull-tabs, available for a dollar each at most charity bingo games. Only the most backwards states would require a machine to have a slot to be a gambling device.

In fact, under any definition, the current batch of video lotteries are nothing else but slot machines. The player has to put money directly into a slot on the machine and some set amount, up to say $600, is paid directly to winners on the spot. The fact that winnings larger than $600 require a trip to the lottery office does not make the devices non-slot machines.

There is one difference between slot machines and video lotteries; it is a difference that is not significant under the law but should be to any player. Both slot machines and video lotteries can be set for any pay-back. Traditionally slots are usually set

to take about 15% of the amount bet; over time they will pay back 85%. Lotteries on the other hand often pay out less than 50% of the amount bet. Nebraska had chosen to set its video lotteries at payouts close to those of traditional slot machines, but there is no guarantee that other states will be so generous to the players. The high roller slot player may not be so foolish after all: it is a much better investment to gamble $5,000 in a slot machine than to bet the same amount on any state lottery.

The other big movement is in video poker: machines can be found in bars and arcades from New York to Hawaii. The Permanent Subcommittee on Investigations of the United States Senate estimated that illegal gambling through "gray area" video devices ran to $15 billion a year. As Eugene Christiansen, one the nation's foremost experts on legal gambling, demonstrated the Senate's estimate is clearly far too high; all U.S. coin-operated amusement machines (like Pac-Man) grossed only $5.5 billion in their best year and all U.S. movie theaters sell only $4 billion in tickets each year. Still, the fact that the Senate is investigating and considering legislation and a figure like $15 billion can stand unchallenged in the popular press shows how widespread these machines have become. Raids are reported in the press regularly. Video poker has become so popular outside of licensed casinos that an episode of the popular television show "Hill Street Blues" featured a bar being closed down for having the machines, without having to explain what the machines were all about.

A video poker machine looks somewhat like other video arcade games. They have a video screen and a coin slot. When you put in a quarter the screen displays five playing cards. There are buttons under each card so the player can keep those he likes and discard the rest in the hope of a better hand on the draw. The machines can be set for any payout, for casino machines usually a pair or jacks or better are needed. Payouts vary from one coin for a pair to hundreds of coins for a royal flush. In non-casino games the payouts are in credits instead of coins.

One new and legally untested variation allows the machines to be switched from one computer program to another. The gambling program pays out varying amounts for winning hands. However, another program can be installed with a flip of a switch. This second program eliminates the possibility of winning free replays and thus is not a gambling device: there is no prize. There must be a lot of switches flipped when the police arrive.

Since raids on video poker machines have become commonplace, the manufacturers have had to come up with ways of hiding the outward appearance of the games while maintaining the way the game is played. In a transparent ruse to appear to be a non-gambling video arcade game, poker is now being played with images of dwarfs, balloons and castles instead of cards.

"Dwarfs Den," for example, flashes the image of five dwarfs on the screen, instead of five cards. Dwarfs come in four different colors and are numbered from 1 to 13. You can "Zap" a dwarf exactly the same way you can discard a card on

a regular video poker machine. Winning combinations are the same as in poker: "Thin Twins" is a pair of aces; all of the same color, "Green Brothers," "Lavendar Gang," is a flush; a "Generation" is a straight; and, a "Family" is a full house, and so on. Changing the images does not change the legal characteristics of the game, unless the anti-video law is so poorly written that it only outlaws the specific game of poker when played with the images of playing cards.

The legal question is whether or not these latest inventions are gambling devices—is a video poker machine a slot machine in the eyes of the law?

Although there is no hard and fast rule for defining what is and what is not a gambling device, the courts of the United States are in complete agreement about at least one coin operated machine: the traditional coin-in-the-slot, three reel, one-armed mechanical bandit, if operational and played for money, is a gambling device.

But inventors are creating new devices all the time; how is a court going to be able to tell if a particular machine is a gambling device or not?

Like much of the law in general, the law of gambling is built on at least two levels:

1) When the law is first made, usually by the legislature or the courts, the lawmakers have a specific example in mind. I like to call this the paradigm case. The lawmakers may not be able to think of every possibility but usually they don't even try. They are faced with what they think is some potential harm to society: a rise in 18 year old drunk drivers, a government budget that is way out of whack, widespread pornography. And so they react: they raise the drinking age to 21, propose a constitutional amendment requiring a balanced budget, outlaw pornography. In gambling law the paradigm case is the traditional slot machine; like pornography, the lawmakers may not know exactly what gambling is but they know it when they see it.

The troubles begin when the law starts to be applied in cases that are not exactly like the paradigm. What you may call pornography I may call great art, or at least free speech. Is the movie "Indiana Jones and the Temple of Doom" pornographic because of its graphic violence? Ask a devout pacifist. Is *Playboy* pornographic because of its nudity? Ask someone in Times Square in New York and you'll get a different answer than if you ask a farmwife in Kansas.

Take a three reel slot machine and add a candy dispenser, have the pay-outs in free plays, add an element of skill as well as luck and maybe you don't have a gambling device anymore. Is a Space Invaders game a gambling device? The farther away you get from the paradigm case, the less likely it is that a court will apply the law to you.

2) The law also works on a second level: courts look at each law and analyze it in terms of its elements. What is there about one-armed bandits that make them different from, say, pay telephones? In both you put your money in and do something to the machine, expecting something to happen as a result. But clearly a pay phone

is not a gambling device that has to be regulated by law (the price of a phone call may have to be regulated, they've raised them to twenty cents in California, but there is no perceived harm to society from the pay phones themselves as there is a perceived harm with gambling devices).

Courts have found that every gambling device has three things in common with every other gambling device: the player pays something of value (consideration) to use the machine; if he wins he receives something of value, usually considerably more than the amount bet; and the outcome depends on chance. If all three of these elements are present the machine is a gambling device; if any one is missing it is not a gambling device.

The major difference between a legal vending machine and an illegal slot machine is that the vending machine does only two things: it takes your money and delivers something of equal value each time, the payout of the gambling device will vary according to chance. Of course, there are an awful lot of vending machines that take your money and deliver nothing, or hot coffee without the cup, or even give you change when you don't deserve it, but the machine is not designed, at least in theory, to have the payout depend on chance.

Currently popular in supermarkets and drug stores are vending machines that dispense little plastic eggs. The eggs are transparent so the customer can see what goodies are hiding inside. For a quarter anyone, even a small child, can win an egg containing a watch or possibly even a $5 bill; or some worthless candy. The machines are classic slot machines. I do not know why the operators have gone unscathed for so long, except that the police and prosecutors have never been anxious to bust small time gambling. I suppose that even if they suspect the machines are illegal gambling devices they fear the adverse publicity involved in fighting such a law suit when violent crime demands their immediate attention. It would be interesting to know who runs these machines and how many millions of dollars in cash they take in each year in a city the size of Los Angeles.

Pay phones and cigarette vending machines are different from a one-armed bandit: although all take in coins and pay out something of value, only the payout from the traditional slot machine depends on luck. Notice that the thing of value can be something as intangible as a phone call or of such questionable value as a cigarette. What if the thing of value is a free game, the entertainment of playing the machine itself another time?

Some courts have held that free replays are not of any value, so the machines continue to operate. Many courts have ruled that free replays are things of value, which has had the side effect of wreaking havoc on legitimate pinball arcades. The law often seems to have no common sense. It is not difficult for anyone to see the difference between a legitimate amusement device that gives a free replay and a gambling device that gives what properly should be termed "credits" in the hundreds.

The free replay is actually a not very subtle subterfuge for a gambling device that pays out in cash. A gambling device, like the gambling pinballs where you line up balls in holes like bingo to win, pay off in free replays in the hundreds. The bartender or store owner will pay off the winner and knock the free replays off the machine with a knockoff switch. Of course, if a cop is standing in the bar, the poor winner is going to have to play those free replays. No true amusement device offers free replays in the hundreds; who would want to play for days? But a gambling device disguises the payout by displaying "free replays" rather than cash prizes.

The free replay is typical of the way gambling operators have worked around the law. Some fairly smart operators saw how the courts were interpreting the law and figured out ways to disguise their gambling devices. Every little variation in a machine had to be fought through the courts before it was declared to be a gambling device. At the very least the machines would be in operation and making money until the end of the court case.

Of the three elements (consideration, chance and pay-out) the paying out of something of value was the easiest to hide. Slot machines were invented that dispensed almost worthless mints with every nickel played so the operator could say that the customer always received something for his money. The early courts were split on whether this converted the slot machine into a legitimate vending machine, until it was pointed out that players continued to put in their nickels long after the mints had run out.

The Mills Novelty Co. fought a series of cases in the early 1930s trying to prove that putting a mint vending device on the side of a slot machine took the entire contraption out of the prohibition on gambling devices. Actually, Mills probably never thought it would win. But what it did achieve was repeated court orders allowing its machines to remain in operation until the final appellate decision had been rendered.

Other machines dispensed tokens good for free plays. Each token was conspicuously stamped "for amusement only" and "not redeemable." You still see these around. Again the early courts were split on whether the player was able to win "something of value" when all he got was a seemingly worthless token; until the courts held that a free play was in and of itself a thing of value. Of course sometimes the prosecution was able to prove that the tokens were being redeemed for cash. No one disputes that cash is something of value.

When the police and courts started closing in on the traditional slot machines, ingenious variations were tried. Some models issued tickets with different payoff values printed on them. Even the mint and gum dispensed by these early machines were marked with various colors or had marked wrappers that were keyed to payoffs. The operators argued that the paper itself was a mere scrap and not a thing of value. But the papers, like the tokens, could be redeemed for cash.

Machines were created that dispensed fortune-telling or humorous cards at the drop

of a coin, allowing the slot operator to color key the payoff directly to the cards. A few machines tried to confuse the law enforcement authorities and courts by posing as vending machines. Slot machines dispensed cigarettes, cigars, golf balls, and, during World War II, ration tokens.

Since the laws were written to eliminate the traditional three reel slot machines, they often contained language specifically prohibiting those gambling devices that operated by the insertion of a coin. The smart operators quickly modified their machines to eliminate the slot. Payment for playing was made directly to the bartender or store owner who pressed a remote control button setting up the machine for play. For at least a short while these devices flourished because they did not fall within the specific language of the statute, and the courts had no power to declare other gambling devices as illegal.

If the courts have had trouble determining when a winning was a "thing of value," imagine the problems they faced when machines came out that challenged the second required element: chance. If the winnings are based on skill and not luck it simply is not a gambling device.

A machine was invented that showed the guaranteed payoff of the next nickel played. All the player had to do was drop in his coin to win, if the display showed that it would pay off on the next play. The operators argued that no "chance" was involved since the win was guaranteed. If the machine did not show the future guaranteed payoff, the player could keep putting in nickels until the indicator again registered a future win. It did not take the courts long to see through this subterfuge.

Other machines had buttons under each reel. The argument was made that a player having the right amount of skill could beat the machine by stopping the reels at winning combinations. Prosecutors were able to prove that the reels spun so fast that no one on the face of the Earth had the requisite amount of skill.

The "crane" or "digging type" machines that are still seen in some amusement areas were ruled to be illegal gambling slot machines in New York. The court found that the smooth teeth of the crane and the short time allowed its operation made it impossible to retrieve the valuables buried deep in the candy without a great deal of luck.

One of the most important developments in the world of gambling in recent years has been the spread of video poker machines. As a footnote for future historians, it is interesting to note that the rise of the video poker machine occurred at the same time as a renewed interest in poker swept the country.

The card game of poker received a big boost in 1970 when Binion's Horseshoe in downtown Las Vegas initiated the first World Series of Poker tournament. Colorful tournament winners like Texas Dolly Brunson and Amarillo Slim kept the game of poker in front of the public's eye. Within ten years the number of licensed poker tables in Nevada went from 85 to over 430.

Other jurisdictions noted Nevada's success. There have been hundreds of licensed poker clubs throughout California for decades, but until recently only the city of Gardena had a number of large clubs, each club having up to 35 tables. Nearby cities, sometimes hit hard by the need to generate income in the face of a public tax revolt, have begun experimenting with poker, often to great success. A massive club opened on August 1, 1983, in the City of Commerce with 100 card tables. This was soon surpassed by a true giant.

The largest card casino in the world opened on November 30, 1984, in Bell Gardens, a small suburb of Los Angeles. The Bell Gardens Bicycle Club has 120 card tables. With 80,000 square feet of floor space the Bicycle Club could well be the largest casino, of any type, in the world: the MGM Grand is close, but by comparison Caesar's Palace in Las Vegas and Resorts International in Atlantic City are 20% smaller, each with casino floor space of 60,000 square feet. And the Bicycle Club is limited to draw poker, lowball, panguingue, and pai gow.

Other states, particularly those in the west, have made poker legal, even when the game is played in a club that runs the game for a profit. So the simplest question should be: is video poker, poker?

The highest courts of two states have decided exactly that question. In a pair of decisions that gladden the heart of a law school professor the Supreme Court of Montana and the Supreme Court of Ohio looked at identical draw poker video machines and came up with completely contradictory results. The Ohio Court declared that draw poker machines are poker and are therefore illegal. The Montana Court declared that draw poker machines are *not* poker and are therefore illegal.

How could two courts faced with exactly the same question and set of facts come up with results that not only are opposite but are contradictory on many levels? Both Courts ruled poker machines illegal; one because it found they were poker games and the other because it found they were not.

The Ohio case was decided first. The case was entitled *Mills-Jennings of Ohio, Inc. v. Department of Liquor Control*, 435 N.E.2d 407 (1982), and involved a question of whether video poker machines were "gambling devices" *per se*. If something is a gambling device *per se* it is illegal as a matter of law and can be confiscated and destroyed as contraband, even if it is never actually used for gambling. A regular three reel one-armed bandit is a gambling device *per se* because it can be used for no other purpose but gambling. A deck of cards is not because, although it can be used for gambling, it can also be used for games of skill and amusement.

The Supreme Court of Ohio discussed the history of gambling laws in that state at considerable length, but dismissed the question of whether video poker machines are poker with just a few sentences. The Court stated simply, "Whether the game being played is on a video screen or a card table makes no real difference. In whatever way the game is played the object is the same and that is to win by obtaining the

best hand possible. Therefore the game being played on the machine is a game of 'poker' . . . " Having found the machines are "poker" it was easy for the Court to point to two laws that specifically make poker a "game of chance" and which outlaw an apparatus designed for use in connection with a game of chance.

The Montana case, *Gallatin County v. D & R Music and Vending, Inc.*, 676 P.2d 779 (1984), decided the same question, but under a different set of laws. Under the Montana Card Games Act poker is legal in that state. If video poker is poker and poker is legal then the machines could not be illegal; you could say they would be legal *per se.*

The Montana Court, in a 4 to 3 decision, struggled hard to find video poker is not within the definition of real poker. The Court said that "No variation of poker involves only one player," and that "It is a game played with playing cards, not with electronic images displayed on a screen." 676 P.2d at 784. Since it is not poker, the Court reasoned, it must be a slot machine and therefore illegal.

The three justices who dissented pointed out that this same Montana Court had held video keno machines were legal since keno was legal, regardless of the fact that the machines had a video screen instead of paper sheets and numbered balls.

In one of the most unusual court decisions ever written Justice Sheehy took the majority to task—in a 57 line poem. I cannot reprint the entire decision, but the highlights are:

> " . . . Well, I have looked at Hoyle, and to tell you no lies.
> There are as many kinds of poker as it has entered into the heart of man to devise. . . .
> But putting fences around what poker means is as preposterous
> As arguing how many angels can stand on the point of a rhinoceros.
> Finally, if there is anything that a Draw-Poker machine can be thought to mean
> It is not a slot machine.
> A chimp can be taught to play mindlessly on a one-armed bandit
> But most humans won't learn not to discard aces or not to draw to an inside straight, if we are the least bit candid. . . .
> Poker players of Montana, unite! Come out of the closet, or at least turn on the closet light."
>
> —676 P.2d 786, (Sheehy, J., dissenting).

What should have been an easy question for the law to decide—"Is video poker a type of poker game or is it something else?"—turns out itself to be something else. The two leading cases came to exactly the opposite conclusion, although the bottom line for the operators was the same. To recap: The Montana Supreme Court ruled that video draw poker machines *were not* a type of poker and were therefore illegal;

the Ohio Supreme Court ruled the identical machines *were* a type of poker and were therefore illegal.

In a third interesting decision the Appellate Court of Illinois was faced with an almost, but not quite, identical question. The case was entitled *Yasin v. Byrne*, 121 Ill.App.3d 167, 76 Ill.Dec. 683, 459 N.E.2d 320 (1984), and involved a demand that the city of Chicago (the "Byrne" in the case name refers to former mayor Jane Byrne) issue tax emblems so that Yasin could install the machines in public places in the city.

The two machines in question were "Monte Carlo Blackjack" and "Draw 5." The trial court held that the two machines were programmed to simulate exactly the card games of blackjack and draw poker. The trial court went on to hold that the blackjack video machine was a game requiring skill and therefore was legal; so the city was ordered to issue the tax emblem. The trial court's ruling on the draw poker machine was another matter: it held that "Draw 5" was a game of chance and was therefore illegal as a slot machine.

The appeal on "Monte Carlo Blackjack" was not pursued, which means the prosecution conceded that the video blackjack machine was legal. The city attorney of Chicago, or any other city, county or state prosecutor could still start a fight over video blackjack since the trial court's decision is not binding on any other court; but it is interesting that the city attorney in this case thought he had no chance of winning on appeal.

The issue of whether video poker is legal *was* fought on appeal. The Appellate Court reviewed all the evidence and decided that the trial court was wrong: the Appellate Court ruled, in a statement that should be of interest to all poker players, "The evidence shows that 'Draw 5' exactly simulates the card game of draw poker, and that draw poker is a game requiring skill . . . " 459 N.E.2d at 323. Since the law of Illinois specifically excludes coin-operated devices which depend in part upon skill the Appellate Court reversed the trial court. "Draw 5" machines are legal in Chicago.

Notice that I said "Draw 5" machines and not video poker machines, and that I said "legal in Chicago" and not "legal in Illinois." The effect of this decision on the rest of the state is not clear; remember this was not the Supreme Court of Illinois. It apparently is the law, unless overruled by the state's highest Court.

But one fact that is very important, for players and operators, is the distinction inherent in the Appellate Court's decision between "Draw 5" machines and other video poker machines. The "Draw 5" machines do not return cash or tokens that can be exchanged for cash, and they cannot be altered or modified to do so. The machines do not even give free replays to winners, nor do they store point totals that can be knocked off by the operator for cash. In other words, it is impossible to win anything other than amusement off of these machines.

The lack of a money payout, or anything that can be redeemed for cash, is fun-

damental to the Court's decision that these machines are not illegal. Although this court ruled that video poker was a game of skill and not purely chance (the second element of gambling), it also made clear that these machines were legal because they did not pay out money, property or the right to receive money or property (the third element).

Would a video poker machine be legal in Chicago if it paid out winnings in cash? Probably not; the law in Illinois is clear that the amusement machine exception to the ban on gambling devices requires not only that there be skill but also that the player cannot win money or property.

However—and there is always a "however" in the law—Illinois law also specifically allows amusement machines to give free replays.

Say you find a video poker machine in a bar that gives free replays. To the casual observer a free replay is just another chance to play the same machine; but regular customers know that the bartender will pay off the free replays won in cash. Free replays thus become "the right to receive money or property," 459 N.E.2d at 323, and the machine becomes an illegal gambling device—if the police can catch the bartender in the act of paying off in cash.

I am willing to bet that Chicago, and probably almost every other city and town in Illinois, will soon have video poker and blackjack machines giving free replays—for amusement only, of course.

Is video poker a game of skill? The Illinois Court thought so, but other courts have not been so charitable. Trial courts have given mixed results, with the majority finding video poker is not a game of skill. Although only a few cases have been taken up on appeal and reported, except for the Illinois case the courts of appeal have been unanimous in finding that video poker is a game of luck.

Pennsylvania is typical of the confusion over these machines. Various trial courts in the state came to various decisions; some finding video draw poker machines were gambling devices per se, other courts holding that they were games of skill. If the machines required skill then they could not be confiscated and destroyed unless players were caught in the act of betting on the results.

The Supreme Court of Pennsylvania finally had to resolve the issue. The Court first found that the machines did not exactly simulate the game of poker, because it eliminated some of the skill elements in raising, calling, etc. The Justices went on to state, without much conviction, "[W]e believe that the element of chance predominates and the outcome is largely determined by chance. While skill, in the form of knowledge of probabilities, can improve a player's chances of winning and can maximize the size of the winnings, chance ultimately determines the outcome because chance determines the cards dealt and the cards from which one can draw—in short, a large random element is always present." *Commonwealth v. Two Electronic Poker Game Machines*, 502 Pa. 186, 465 A.2d 973 (1983).

All of these cases dealt with the question of whether a video poker machine was a gambling device *per se*, that is, that it was designed to be used for gambling alone and can therefore be destroyed. Other courts have had to face the question of whether video poker was a gambling device not because it had no other use, but because it was actually being used for gambling.

Think of a coin. A coin is not a gambling device *per se* because it is designed to, and does have, non-gambling uses. However, a coin can become a gambling device when it is flipped in the air and bets are made as to which side will land face up. Used in such a way a coin becomes a gambling device and is subject to forfeiture to the state.

The state of Kansas is one of those jurisdictions that finds that a free replay is not "something of value." In 1983, when faced with a video poker machine that only offered free replays, the Supreme Court of Kansas ruled that the machines were not gambling devices *per se* and cannot be seized and destroyed wherever found. The Court did find that they were games of chance and therefore gambling devices if something of value is received as a prize.

The police and prosecutors in Kansas got the message. The next case involved two plain clothes Kansas City police officers who entered a tavern and began playing poker on two video poker machines. One officer won twenty free games on one machine, while the second won eight games on the other. The tavern employee paid the officers cash, $5.00 for the twenty games and $2 for the eight games. After receiving the payoffs, the officers made their arrests and seized the machines.

Although the cops had learned how to make gambling arrests in Kansas, the question for the Supreme Court is what happens to the machines. The Court's answer was that even though the machines had been used for gambling, that did not turn them into gambling devices *per se*. A machine that is a gambling device *per se* can be destroyed automatically, on sight. A machine that is *used* for gambling, but is not a gambling device *per se* can also be destroyed, but only after a full hearing. The state cannot permanently deprive a person of his property without notice and an opportunity to be heard.

It would be interesting to know what arguments the tavern owner will make to prove these machines were not being used as gambling devices. But, at least he will have his day in court.

8
How to Find the Law

What is it exactly that lawyers do? Maybe more pertinent (or impertinent), how do they get off charging so much for whatever it is they do do?

Say you used to have a friendly, neighborhood poker game with the boys about once a week. Although the games were just for fun the play sometimes got pretty wild; and, at a dollar ante, the big loser could sometimes be in the hole two or three hundred dollars. Your next door neighbor, Jim, got on a real losing streak and started writing checks. He asked you to hold them for a while since he was temporarily short of cash. You took the checks, figuring he would make them good.

One day you realized the checks totalled over $2,000.00, and you asked Jim when he was going to pay. He became very upset and wanted to know if you thought he was going to welch out. Well, one word led to another, until you two almost came to blows. Your family and his have now not spoken in over two years.

A few days ago there was another incident: his wife almost hit your wife's car. Words were exchanged, again. This time you thought enough is enough. You dug out those old checks that deadbeat had written and went to see your lawyer.

You tell the whole story to your lawyer and hand him the checks. He asks you a few questions and takes notes on a lined yellow pad.

Finally, you ask him if you can sue.

The lawyer takes a book off a nearby bookcase and looks up something. He puts the book down and takes up another book from the same set. He reads for about a minute, turns to another page and reads for another 30 seconds. He then closes the book and looks at you and says one word.

"No."

He then explains to you why you can't sue, with a lot of legal mumbo-jumbo about "statutes of limitations" and "voidable actions in the nature of assumpsit."

This entire little exercise in futility is going to cost you $50.00 or more. Not only

does that no-good chisler Jim get off scot-free, but you've got to lay out an additional fifty bucks for just a few minutes of your lawyer's time. Fifty bucks for nothing, you think. What a racket. If you knew where to look you could have saved yourself the time and aggravation, let alone the expense.

The first question to ask is why does it cost so much. If you ask your lawyer (a dangerous practice, since the lawyer will charge you for the time it takes to answer) he will tell you that he has overhead, expenses, etc., etc. This is true, in part.

Even in the best run law offices, over fifty percent of every dollar taken in goes out in salaries for secretaries, rent, office supplies, and other essentials; overhead in mismanaged offices can eat up ninety percent of the gross income. Ask your lawyer to show you his office library, and for an estimate of the cost of any one book, including periodic updates. Overhead can run even higher, if you include the salaries for associates (new lawyers who are technically employees) and legal assistants. Of course, associates and legal assistants charge you for their work, and you can be sure that a young lawyer, right out of law school, is not making $100 an hour, even if that is what you are charged for his time. Besides, overhead cannot eat up one hundred percent of your fee, or the law firm would go out of business—there would be nothing left for profit.

The lawyer, if pressed, might talk about the growing risks of malpractice suits. Again, this is a real worry that does indeed increase the cost of legal services. Not only are lawyers forced to pay large premiums for malpractice insurance, an expense that simply did not exist fifty years ago, but every law office spends enormous amounts of time in the practice known as C.Y.A.—"Cover Your Ass."

Some C.Y.A. practices may actually be beneficial, in the long run, to the lawyer and his clients. Most lawyers will spend a part of every work week reading over current developments in the law, finding out about the latest court rulings or procedural changes. This continuing education can be as formal as week-long seminars (at $2,000 each) or as informal as lawyers gossiping about other lawyers or judges (don't underestimate the importance of gossip: the outcome of your case may depend on what your lawyer knows about the lawyer on the other side).

But C.Y.A. can also be one of the greatest wastes of resources imaginable. A careful lawyer will send a cover letter for every phone conversation of any importance. You probably have seen, and maybe even been billed, for some of these: "This letter will confirm our telephone conversation of Tuesday last in which you informed me that your expert witness will not be available until next July; and I informed you that my expert witness would not be available until yours is made available . . . " One of the great unwritten truisms of the practice of law is that the one time a lawyer fails to write a C.Y.A. letter will be the one time that he will need it to back up his claim of what has happened.

But despite all the C.Y.A., including premiums for malpractice insurance, these

costs are simply part of the expenses of being a lawyer. The insurance costs and seminar tuitions are included in overhead. The C.Y.A. letters and time spent on other C.Y.A. activity are usually billed to the client, or simply written off. This time is not really an expense, it simply is time that could have been used more productively earning fees.

If you continue to press for an explanation of why legal fees are so high you may get the answer that it costs three or four years of school and up to $40,000 to earn the right to take the bar examination. Law school is intellectually challenging and emotionally draining; few who apply are admitted, fewer still graduate, and not everyone who takes the bar passes by any means.

I believe this is the real reason for the high cost of legal services in the United States. Not that the lawyer has to earn enough to pay back the cost of law school; that cannot take more than two or three years. But rather, to become a lawyer requires overcoming a number of barriers of time, money and personal crises. Despite what you may have read about a glut of lawyers, American society has enough legal work to keep every lawyer busy all of the time. For every law school graduate who passes the bar there are literally hundreds of potential clients, from individuals, through business partnerships and corporations, to government agencies, each one with a myriad of problems that must be handled immediately.

And lawyers make work for other lawyers. The old story is that one lawyer in a town will starve, two lawyers will grow rich. I have practiced in both Hawaii, where there are less than 3,000 lawyers, and California, which has 85,000 members of the bar. The number of frivolous lawsuits, and even of meritorious claims, is so much greater in California as to be beyond comparison. In California almost every legal issue imaginable has been litigated. There is a lawyer somewhere who will take the case.

One of the best examples is Los Angeles feminist attorney Gloria Allred. Allred has filed lawsuits over claims that her clients were discriminated against because: 1) a woman was asked not to breastfeed her infant in a Beverly Hills restaurant; 2) an expensive restaurant gave a woman a menu without prices; 3) two lesbians were denied a curtained "romance booth" in a third expensive restaurant. Each of these lawsuits required the restaurant to pay for its own attorney to defend the claims. The lesbian case went up to the Court of Appeal, and eventually to the California Supreme Court; the trial court's ruling was reversed, and the case was sent back to the trial court for a new decision. The two lesbians eventually won $250 each and the right to eat in the private curtained booths. The restaurant responded by eliminating all of the booths, thus depriving all couples of this romantic setting. The restaurant was forced to pay the lesbians' legal fees. For her work Ms. Allred received over $27,000.

The reason lawyers charge so much for their services is that they can get it. If

you do not wish to pay $100 for someone to look in those books for you, someone else is willing to pay.

I do not mean to imply that lawyers are selfish, inhumane creatures that are only interested in making the most they can for themselves. Lawyers as a class compare favorably with any other group in their desire to help their fellow man. Like doctors, lawyers start out as students who are interested in being of service to others, and that desire remains throughout their professional life. But also like doctors, lawyers go through a rigorous educational process, in school and in practice, that forces the practitioner to treat each case as part of a larger system. The process is dehumanizing: there is no time to treat each client as a friend, and in the eyes of the law much of what the client has to say is simply irrelevant.

It is also a sad fact of modern legal practice that the lawyer has to spend most of his time thinking of protecting himself. Even the work done on behalf of his clients is often thought of as C.Y.A. efforts to avoid malpractice suits.

This is not to say that lawyers don't care about their clients, any more than doctors don't care about their patients. In fact, too many believe, at least subconsciously, in a "win at any price" philosophy.

Often the lawyer is more concerned about fighting the case than is the client. The most obvious example would be a lawyer whose income and reputation depends on a single case, while the client is a large insurance company that has already put reserves away in case of a loss. But the phenomenon can occur in all lawyers, particularly those we call litigators, the ones who fight the courtroom battles. In a recent law review article published in the *Whittier Law Review* I described how lawyers sometimes become emotionally convinced that their clients deserved to win. I labeled this phenomenon "Litigator's Fallacy."

Of course, it is not only lawyers who have the mistaken belief that their clients deserve to win. Most clients convince themselves that they are right, and the other side is wrong, to the point where both sides in a lawsuit could pass lie detector tests. When one side loses, as always happens, the client blames the judge, the jury, the legal system, but most of all, he blames the lawyers.

Of course, one reason lawyers are so disliked is that in each lawsuit there is always a losing side. Some efforts have been made in the last few years to encourage mediation and negotiation, but our legal system is still based on the adversary process. Lawsuits are a zero sum game, for every winner there is a loser. In fact, there are often losers on all sides, since even the winner usually does not get the full amount won—there are always those attorneys fees.

Non-lawyers underestimate the impact of the adversary process; they tend to think that judges play a much more active role than is true. Lawyers do almost everything in a lawsuit, the judge does not even come into the picture until the case is far along, and then his role is usually limited to making a decision about a particular question

posed by one of the lawyers. In the European system judges play a much more active part, and some are even allowed to conduct their own investigations outside the courtroom. Our system rejects that notion completely; judges for the most part do not even ask questions of witnesses in the courtroom. The American judicial system is built on the fundamental belief that two interested parties, butting heads with the help of their hired advocates, will arrive at justice and the truth.

What do you get for your money? Can you avoid going to a lawyer in the first place? Why can't you go to a public library and look in those books for yourself?

The answer is yes, you can represent yourself. If you are involved in a major lawsuit, outside of sending a letter to the other side admitting everything was entirely your fault, representing yourself is probably the single worst thing you can do. Even the most experienced trial attorneys will hire another lawyer to represent them in a major case. They know they cannot evaluate their own case objectively and deal without emotion with the opposing side. If you are not a lawyer you have the additional handicap of trying to learn how to use your weapons in the middle of the battle.

This does not mean that ignorance is bliss and you should completely rely on your lawyer to do everything for you. First of all, that is a terribly expensive way to run your life; even law firms hire non-lawyers to do their routine billings and collections. Most of the time it simply does not pay to hire an attorney. In California, claims under $1500 must be heard in small claims court and the law does not even allow you to have a lawyer represent you. If you can, you should certainly talk to a lawyer before going to small claims court, just as you should before signing any contract or filing any form with the government. But sometimes we all have to muddle through on our own. I hope this book helps you muddle.

Second, bringing lawyers into a dispute tends to force the issue and may break down whatever tenuous relationship you still had with the other side. Lawyers are an extremely useful tool, when used in the right way and at the right time. I have had a number of business clients who would have me send my nasty collection letter, on legal stationery, when every other attempt at getting payment had failed. My lawyer letter almost always worked, even if the other side had been avoiding payment for months. However, lawyers see the worst in people and may go too far in trying to protect their clients' rights. Many deals, and amiable divorces, have broken down when lawyers became involved.

Third, and I am reluctant to put this in print, but it is true, there are an awful lot of incompetent lawyers out there. How will you know one is incompetent? You could wait until after you have lost your case. Or, you can try to understand what your lawyer is doing.

One of the major purposes of this book is to teach you to ask the right questions. You must at least speak the same language as your lawyer.

The law is extremely complicated, but I feel that a lawyer should always be able

to explain to his client the basic problems, procedures and arguments involved in every case. This is also a good test of the lawyer's competence. To be able to explain the case to his non-lawyer client the lawyer must have a complete understanding himself. And the case might just end up in front of a jury. If the lawyer cannot explain the case to the client, who certainly knows something about what is going on, how will the lawyer convince twelve strangers?

One of the things I want to try and do is demystify the law. I cannot teach you to be a lawyer, or even how to do legal research. But I can show you how lawyers think, how the law works, and what some of those funny abbreviations mean.

Doctors have scalpels, but the lawyer's major tool is language. Lawyers do almost everything in writing, for some very good reasons. A written document is the easiest way to record information in a form that is permanent, quickly understood by others, and able to be distributed to large numbers of people at the same time. None of the other alternatives work as well.

People speak faster than they write, so lawyers often dictate their work, but people hear slower than they read. An entire half-hour news show, if transcribed, would fit on the front page of the *New York Times*. You may be able to reach more people with a speech on radio or television, but lawyers normally do not have to communicate to more than a handful of people at any one time. And what the electronic media gains in public access it loses in content. If you want to convey large amounts of information quickly you use written rather than oral media.

Paper lasts longer than stone, because it can be copied. Preserving information by words on paper makes that information available to anyone anywhere at any time.

The electronic media has made some small inroads into the lawyer's world of papers. Videotaped depositions can have a tremendous impact on juries, although they are still difficult to use to store detailed information. It is difficult to quickly scan an audio or video tape, the way you can flip through a printed book. Laser discs and computerized transcripts may ease the problem of quick access to specific pieces of information, but the processes at present are expensive and, more important, are not readily and universally available.

The computer revolution has hit law firms. Now, instead of photocopying forms out of form books, lawyers call up the forms on their word processors and fill in the blanks. Hard copies are then created and sent out. Direct linkages between law firms and the outside world, say, to communicate directly with opposing counsel or the courts, is still practically non-existent.

Computer assisted research can be impressive. It is fairly easy to find every reported case ever decided by a particular judge, or to uncover cases involving only Puerto Rican casinos trying to collect on bad checks in Utah.

It is important to understand the lawyers' dependence on the written word to understand how the law works. One of the reasons legal documents are so deadly dull to

read is that lawyers have to be extremely careful with each word put down on paper. There is a wonderful, true story about a law passed by the federal government that was meant to tax "fruit and trees." Because of a typographical error the law came out "fruit trees," and the result was a loss in millions of dollars of potential revenue. If a contract to sell slot machines calls the machines "machines" in one part and "devices" in another it is conceivable that a court might rule that the contract was talking about two different items; and perhaps it was.

In normal English we have all sorts of devices for making our writing more interesting, like metaphors and synonymns and showy illustrations and amusing examples. Lawyers feel, usually correctly, that none of this is allowed in legal documents. If craps is listed as an example of games that are outlawed a court might find that craps is the only game that is outlawed, or that the law applies only to games played with dice on a table, or only to games in which the house acts as the bank.

This does not excuse lawyers for their poor use of the English language. Lawyers use legalese because they are lazy, or because they want to appear important. Also, it may be difficult to charge someone $200 for a will that says, "I leave everything to mother." Better to have the will run five pages with a blue back and start out, "Know All Ye Men By These Presents."

At one point lawyers were paid by the word, so there is a tradition of adding superfluous language. Lawyers also try to cover all possible contingencies, which is sometimes to the good. I have found that people starting a new business always think about how they are going to split their profits; they never consider what will happen if there are losses. On the other hand, lawyers are noted for having an overabundance of caution. A will might say, "I leave, give, devise and bequeath . . . " because some courts have ruled that "devise" only applies to real property like land, and the lawyer feels he might as well throw in an extra similar term or two, just to make sure.

Form books have been a boon for lawyers but a bane for clear understanding. The books contain model language for all common legal situations, and many uncommon ones as well. The forms are created out of the language of actual cases, using court decisions determining what certain language means. This is unfortunate because it perpetuates poorly drafted language. Why did a judge have to decide what some particular language means? Because the language was so vague and ambiguous that no one knew exactly what was intended and a lawsuit resulted. Form books can thus be seen as the worst, not the best, language available for any possible situation.

Here's how form books work. Suppose you have a video arcade that includes, among the Space Invaders and Pac People, a video poker machine that pays off only in free replays. You read in the newspaper that the City Council has passed an ordinance prohibiting gambling apparatus and has ordered the Chief of Police to close down every video parlor in the city. You do not know whether the new ordinance will apply

to your business, so you go to a lawyer. The lawyer tells you, quite rightly, that it is better to be the plaintiff in a civil suit than the defendant to a criminal charge. So you agree to file a lawsuit to prevent the police from closing you down. To start the lawsuit your lawyer will file a complaint. The specific relief he requests from the court is an injunction, that is a court order, enjoining the enforcement of this new ordinance.

It turns out that what you are trying to do is not that rare. There is a form complaint that covers your situation, in fact, one publisher alone has produced three forms that apply. The first is entitled "Complaint, petition, or declaration—To enjoin enforcement of ordinance prohibiting, as gambling, games which are actually games of skill." The other two forms are a petition and an order for an injunction against destruction of the devices.

Your attorney photocopies the forms, fills in the blanks, and hands it to his secretary to type up and file. If you are lucky he will have an experienced legal secretary, who will catch any mistakes. If not, you may find yourself paying for repeated lawyers bills over extended fights with the City. Every legal jurisdiction has its own peculiar procedures that must be followed or you may find yourself with a winning case on the merits, that loses on a technicality.

The forms are designed to cover a wide general category of problems and have to be modified to take into account the facts and law of each specific case and jurisdiction. The form books themselves tell the lawyer where to start in doing the necessary research. Unfortunately, lawyers are often too lazy, or ignorant, to do what is required. The problem is not with the form, which can be very helpful and is perfectly okay for the general case. But you are not dealing with the general case, you have a specific ordinance that must be analyzed and a unique set of facts that may, or may not, fit the blanks provided in the form.

There are form complaints for the loser to recover his gambling losses from the winner, for recovery by the wife of the loser, by a casual bettor against a professional gambler, and for recovery from a stakeholder. For the defendant there are form answers denying that the defendant won, and others alleging that the contract being sued upon was one for illegal gambling and therefore not enforceable. There are even such specialized forms as an answer that a contract being sued upon was actually a wager on future commodity prices and is therefore unenforceable; and a complaint to recover money given in payment of a gambling debt to cheaters.

Form books can be helpful, but the lawyer should be doing his own research to discover what the law is. That is where all those abbreviations come in. We call them citations, and they allow a lawyer to find the law.

What we call the law does not spring out of the air. It comes down, in the form of written documents from three main sources: the legislatures (Congress and the various state legislatures), courts (both federal and state) and administrative bodies

(federal, state and local). There are additional sources of the law (such as the United Nations Charter and the World Court for international law) but we can ignore those. For gambling law we are primarily concerned with statutes passed by legislatures, the common law decisions and interpretations of constitutions and statutes made by courts, and the regulations and rulings of administrative agencies.

We have already discussed one set of statutes: the federal laws passed by Congress. The statutes passed by Congress that become law are compiled in two kinds of collections: Statutes at Large (abbreviated "Stat."), which contain the statutes in chronological order, and the United States Code (U.S.C.). So when you see a citation to Stat. you know it refers to a federal statute and the numbers will tell you where to find a copy of the law.

Citations in the law often give you alternative sources for finding the same law. All statutes passed by Congress will be listed in the Statutes at Large, and should also end up eventually in the set known as the United States Code.

The U.S.C. is much easier to use because it is set up by subject matter, not chronological order. The U.S.C. is divided into 50 "Titles," each title dealing with a separate subject matter. Title 18, for example, contains the federal laws dealing with crimes and criminal procedure, while Title 26 is the Internal Revenue Code.

Statutes are given standard citation forms, to make them easy to find. For example "7 U.S.C. Section 12a" refers to a specific part of an Act passed by Congress. You need not know that Title 7 deals with Agriculture; you can find the law by picking up Title 7 of the United States Code and flipping through until you find Section 12a.

Each state also has its own set of statutory law. California has statutes on everything and divides them by topics: "Cal. Bus. & Prof. Code Section 12a" means the California Business and Professions Code, Section 12a; "Civ. Proc." means Civil Procedure. Sometimes there are rival systems of citations. California's Code of Civil Procedure can also be abbreviated "CCP." Hawaii has simply one set of statutes: the Hawaii Revised Statutes, abbreviated "HRS" or "Haw.Rev.Stat." The most useful editions of statutes are called annotated codes because they contain in addition to the exact language passed by the legislature, the prior history of the law, and summaries of all cases interpreting the law.

You have to be careful sometimes in reading the citation. Section 12a is not the same as Section 12(a). The numbering system is sometimes screwy. Section 12 may have three subsections: 12(a), 12(b) and 12(c). Later on, the legislature may have decided to add a new section, but there already was a Section 13. So they simply created a new number, Section 12a, and squeezed it between the existing Section 12 and 13. Twenty years later the legislature may pass a new law, and decide, for some reason to number it Section 12.1.

Administrative rules are handled like statutes. Federal administrative rules are collected in a chronological set known as the Federal Register (Fed. Reg.). They are

also rearranged by topic in the Code of Federal Regulations (C.F.R.). Decisions by the federal agencies of cases that come before them may also be available in a set.

State administrative agencies are a mess, the only way you can find out what decisions they have made is to contact them directly, and even then you may find yourself out of luck.

I found the Nevada Gaming Commission and State Gaming Control Board to be helpful and cooperative. They responded quickly to my every request, and charged nominal prices for their information. The New Jersey Attorney General's Office was also helpful, sending me piles of information at no cost.

And then there is the New Jersey Casino Control Commission. I cannot even get a response from them, despite repeated letters. When I visited them in person I was informed that copies of their documents were available at $1.00 per page. Fortunately, the casino newsletters fill in many of the blanks caused by the Atlantic City regulators.

Private publishers, like Commerce Clearing House (CCH) provide valuable, though expensive services in special fields. There is no gambling law reporter, but there are services covering statutory, administrative and case developments in virtually every other field, from the Abortion Law Reporter to Workmen's Compensation Law Reporter. These services are the best way to follow actions taken by administrative agencies.

Most of the citations you see are to cases decided by courts. Students in law schools spend most of their three years reading and analyzing cases. This is unfortunate in one respect: it downplays the importance of statutes and administrative rulings. In fact, I do not believe that any law school in the country requires students to take a course in Administrative Law. Classes in statutory law are hit and miss; it is usually stressed in Criminal Law, but not always. Other classes where the study of statutes is important—Tax, Corporations, and Securities Regulation—are also not required.

I have seen law students, and even lawyers, spend hours reading through dozens of cases from all over the country trying to find some bit of law, when the legal question had been settled by the state legislature. Take the example I gave at the beginning of this chapter: the lawyer only spent a few minutes deciding that there was no way to collect on the poker debt. He could have gone to his law library and spent all day searching through the case reporters and digests, time that you would be billed, looking for the answer. Instead, he picked up the index to his state statutes, found a reference to gambling debts and looked up the statute. Perhaps the statute said gambling debts, including checks written for home poker games, were not collectible in a court of law; or that a lawsuit had to be filed within one year from the date of the game. Of course, if the checks were for $10 million it might be worth doing further research, or trying to come up with a novel legal theory to invalidate the statute.

The series of numbers you see after a case name refers you to a particular "reporter,"

a collection of cases. There are rival publishers, each reporter containing court decisions in chronological order. The same case may be reported in three separate reporters, besides the services described above. This results in what we call parallel cites. Although it is a pain for lawyers, it makes it easy to find a case since you can go to any one of the sets and find the identical text. It also tells you at a glance which state and which court issued the decision.

The case abbreviations are easy to read once you know the system. The first number is the volume number, the letters stand for the reporter, and the last number is the page. Therefore, 198 U.S. 500 (1905) is volume 198 of the United States Reports (the official reports of the U.S. Supreme Court) and the case begins on page 500. (It was decided in 1905). *In Re Allen*, 59 Cal.2d 5, 27 Cal.Rptr. 168, 377 P.2d 280 (1962) was decided in 1962 by the highest court in California (the California Supreme Court). The same identical case can be found at volume 59, page 5 of the set of cases known as California Reports Second Series, and at volume 27, page 168 of the set called California Reporter, and at volume 377, page 280 of the Pacific Reporter Second Series.

Cases from the federal courts of appeals are found in the Federal Reporter (F. and F.2d). Federal district court cases are reported in Federal Supplement (F.Supp.).

State court cases are collected in separate reporters for each state, abbreviated by the state name. The cases are also collected in regional reporters. All law libraries have the regional reporters, because it eliminates having to buy the separate sets for each individual state. The Southern Reporter, for example, carries cases from Alabama, Florida, Louisiana, and Mississippi. The regional reporters are: Atlantic (A.), North Eastern (N.E.), North Western (N.W.), Pacific (P.), South Eastern (S.E.), South Western (S.W.) and Southern (So.).

There is much more to finding the law, but not that much more. If you have the citation any law librarian can find the work. Cases are the easiest to find, because the library will have at least one set of reporters, if only the regional reporters. Statutes and secondary sources like services and law reviews are more scarce, but law libraries are very helpful on inter-library loans.

The most important thing you have to do when you have finally found the law is to read each and every word.

Many states have recently amended their criminal codes to allow collectors to keep antique slot machines; without such a law the machines are gambling devices and are subject to seizure and destruction, no matter what they are worth. California Penal Code Section 330.7 states, in part as follows:

> "It shall be a defense to any prosecution under this chapter relating to slot machines . . . if the defendant shows that the slot machine is an antique slot machine and was not operated for gambling purposes while in the defendant's possession. For the purposes of this section, a slot machine shall be conclusively presumed an antique slot machine if it was manufactured prior to 1941."

The law means what it says, but it takes a careful reading to understand it fully. In every criminal case the prosecution has the burden of proving beyond a reasonable doubt each and every element of the crime. Yet this statute seems to put the burden on the defendant? Is that constitutional? Yes, because we are not dealing with an element of the crime of possessing a slot machine, we are giving the defendant an affirmative defense. Without this defense the collector would be guilty of the crime of having a slot machine.

What does the defendant have to show? Not just that it is an antique. The burden is on the defendant to also prove that the machine was not operated for gambling purposes while he had it. How can he prove that? The collector can take the stand and testify that he never let anyone use it. But if there are newly minted coins inside, or someone says they used it at a party, or the jury simply does not believe the collector he will be convicted and his antique destroyed. The language of the law practically requires the owner to plug up the slot, only then can he be sure he'll meet his burden of proof.

What about the antique part? Is the owner out of luck if the machine was manufactured in 1942? Not at all. The language of the law is clear, if read carefully. If the collector can prove it was manufactured before 1941 he has proved it is an antique, the issue is "conclusively presumed," which would indicate the prosecution cannot offer any evidence to show it is not an antique. If the machine was made after 1941 there is no automatic result, but the collector can still put on evidence to show that it is an antique. What type of evidence? Normally, issues such as this require expert witnesses, say an antique dealer, who can testify under oath that in his opinion the machine is an antique.

Although the law was clear in theory, in practice it had been a mess. The problem was that many slot machines have some parts manufactured before 1941, and some parts after, while other machines are either reproductions of earlier models or are considered antiques by traders, though manufactured after 1941. On September 18, 1985, the Governor of California signed a bill, changing Penal Code Section 330.7, in an attempt to set up an objective standard of what is an antique slot machine:

> "For the purposes of this section, the term 'antique slot machine' means a slot machine manufactured in the United States of which two-thirds or more, by count, of the visible exterior metal components (excluding fasteners) are original equipment manufactured prior to 1956; provided, however, that if the machine has a front or top casting, or both, the front casting or the top casting must have been manufactured prior to 1956."

Every law can be analyzed in the same way. What a lawyer does, or at least what they are supposed to do, is to read, carefully, every word of the applicable law, analyze it, and then apply the law to your particular fact situation, using the general prin-

ciples they learned in law school. If you have a legal problem related to gambling go to your lawyer. If you do not understand what your lawyer is saying, after you have read this book, the chances are that the trouble is not one of communication, the trouble is with your lawyer.

9

Gambling and Taxes

Gambling, whether legal or illegal, has one characteristic that makes it stand out from most other American businesses: the goods and services being "sold" are money. This makes it uniquely subject to regulation by government tax authorities.

There is really nothing like gambling as an enterprise. On the legal side of corporate America there are banks and other financial institutions that deal in cash. However, these are highly regulated, and every business transaction creates a paper record.

On the illegal side there is a large underground economy, estimated to be in the billions of dollars. Floating around the United States today is nearly $80 billion in cash, $30 billion in the form of $50 and $100 bills. Only five percent of the bigger bills are in banks. Counting all other legitimate uses of big bills, at least $40 billion remains unaccounted.

Much of this is illegal gambling, but almost anything else can be bought for cash or swapped in unreported exchanges. Unreported cash transactions are not limited to prostitutes and drug dealers; there are farmers, barbers and even lawyers who are willing to sell you food, cut your hair or draw up your will for cash or a trade, no questions asked. But most of this underground economy involves the supplying of goods or services, even if there are no paper records. On the criminal side, besides gambling, probably only usurious loans—loan sharks—have money itself as the business commodity.

Since gambling's only commodity is cash, the government uses its taxing power to generate income and, more importantly, to control the activity. In most other businesses the paying and reporting of taxes are used solely to raise revenue. When it comes to gambling, raising revenue is often secondary to catching crooks.

It is always easy to impose or raise taxes on what is viewed as a vice, the so-called sin taxes: alcohol, tobacco and gambling. The idea is that people shouldn't be doing

these things anyway, although we can't stop them, so the government might as well make some money off of it. And by making the vice expensive the government can control and limit it. No politician ever got votes by advocating that the sin taxes should be lowered.

Sin taxes are not new. One of the first tests of the new United States government after the Revolution, and the first tax revolt, was the Whiskey Rebellion in 1794. One of the first taxes imposed by the new Congress was an excise duty on whiskey. The problem was the remote farmers in western Pennsylvania refused to pay the tax since they viewed whiskey as a medium of exchange, not as a vice (it cost too much to ship grain so they converted the grain into whiskey for trading).

Since it is easy to impose sin taxes, every taxing authority does it. For an industry like liquor the result is having to deal with 50 state laws, each one requiring different size bottles.

Since it is easy to raise sin taxes, every taxing authority does that, too. Taxes can be raised as if there were no limit; no one with any political clout will complain, the way they would if income, sales or property taxes were raised. If the lawmakers think at all about the impact of higher taxes they figure the consequences will be positive: if the tax becomes too expensive people will just have to cut down on their vices.

What the government does not realize is that even vice is subject to the laws of economics. Maybe more so than "legitimate" businesses, since many of the sinners are addicted and cannot quit, even if they wish. Raising the costs of a legalized vice through taxes can drive customers into the arms of illegal entrepreneurs, who will supply the public demand at a cheaper price. The laws of supply and demand are not limited to respectable goods, or even to gambling. When the taxes on cigarettes soared illegal operators hijacked trucks to cash in on the unfulfilled demand.

Government knows what it wants to do with the gambling tax laws: it wants to raise money at the same time as it controls illegal gambling. An analogy can be made to tariffs. The government puts a tax on certain imports not only to raise money but to protect home industry against foreign competition. Sometimes, when local industry is really in bad shape, the tariffs become walls to completely prevent foreign goods from being imported.

The problem with using the tax code for other than raising revenue is twofold. On a philosophical level the tax laws were not created for these ulterior purposes; in effect it is a misuse of the law that can lead to further misuse. Was it proper to bust Al Capone for tax evasion when the government could not convict him of anything else? Would it be proper to use it similarly against others? The government once closed down some newspaper publishers it didn't like for non-payment of taxes.

On a practical level the government has always had trouble predicting the consequences of using the tax code for non-tax purposes. One reason taxes are so com-

plicated is that lawmakers immediately think about giving a tax incentive to every program the government wants to implement, from day care centers to windmills. In gambling, government messing with the tax laws has ramifications for millions of people and goes far beyond the mere catching of crooks.

With gambling, the federal and state governments have, on occasion, used the tax laws primarily for control, with raising revenue a secondary goal at best. To effect control, the major weapons have been to require gambling operations to document their cash transactions and to send reports to the regulatory officials. Economic controls, taxing the illegal games out of business, has been rarely used, since this is clearly a misuse of the power to tax. The power to tax is the power to destroy, but not in this country.

In gambling money changes hands so quickly and with so little documentation that the event is impossible to reconstruct without eye witnesses. For legal games this means without documentation the regulators are nearly powerless to control the flow of cash. Lack of control of the cash leads to all sorts of problems, including secret criminal ownership, bribery, corruption, and evasion of taxes. For illegal games, by definition, the entire enterprise exists because law enforcement is unable to stop the exchange of money.

The legal games have fought against stiffer controls by the government of their cash flow as long as there have been legal games. The lone exception is the state lottery, which is the government.

In the past legal casinos may have fought against reporting requirements because of secret criminal ownership. Today, the fight is over independence, the cost of record keeping, and interference with the play of the games.

Imagine having to fill out the forms required for a cash deposit at your bank every time you wanted to place a bet on a roll of the dice at craps. The technology does exist for having players deposit money in advance and bet on computer consoles or the like, but nobody is seriously advocating that type of control. The regulators are for the most part satisfied with the cash documentation requirements they now have in place.

Controversies continue to erupt over the tax regulation of legal games. The IRS fought for years to get the casinos to withhold taxes on the tokes (tips) given casino dealers. And the IRS has apparently never been successful in stationing agents in the cash counting rooms of the casinos.

But the current controversy involves casinos in a somewhat bizarre way.

The Reagan Administration has imposed a regulation requiring casinos to file detailed reports on their high rollers. In addition, the IRS will be able to inspect casino credit files on a routine basis.

Pawn shops, stock and commodity brokers, travel agencies, and jewelers are already required to file these forms. Yacht and car dealers are routinely reported to the govern-

ment. If the Reagan Administration's idea is to track drug dealers through their cash expenditures everybody could be made to report every cash deal: file a form with the government every time you buy or sell land, furniture, clothing or visit your doctor or lawyer. In fact, there is a controversy brewing because the government is trying to get lawyers who receive large cash payments to report the names of their clients.

The attempt to bring casinos under the Bank Secrecy Act reflects a current trend to use the taxing power solely for control. In the past the government has flip-flopped in its attitude toward the two uses of the tax code, raising money and control of criminals, and some of these old laws are still on the books. Sometimes the goal has been to raise tax revenue; at other times the government said it wanted to put the illegal operators out of business. Usually the government said it could do both.

The result has been a mishmash of tax statutes, revenue rulings and court decisions that are overlapping and confusing. Sometimes the law got thrown out completely. When the law is still on the books it often does not amount to much. To borrow a term from accounting, the bottom line is that the tax laws on gambling have obtained neither of their goals. But the laws are still a headache to all gamblers, from bookies to lottery winners.

It is not really surprising that the gambling tax laws have neither raised large amounts of money nor have they put the illegal games out of business. The goals are in direct conflict with each other. If the goal is to raise money the illegal businesses should be encouraged to expand; if the goal is to put them out of business no tax money will be raised.

When the government tries to do both at once it fails. If the tax on gambling is too high it will put the operators out of business. If the tax on gambling is too low there is no incentive for the IRS to try and enforce the law.

An illegal game, by its very nature, is not much interested in obeying the laws. The Treasury Department, which has a very small staff for enforcement relative to the number of taxpayers, is more interested in going after big tax evaders. Why audit a mom and pop operation when you can go after Exxon? The tax money involved in illegal operations is not enough to excite the IRS; nor is the underlying crime. Al Capone is one thing, neighborhood bookies are another. The IRS in enforcing the gambling tax laws is subject to the same pressure as all law enforcement: the public wants the anti-gambling laws on the books but does not really want them vigorously enforced.

The federal government first imposed a stamp tax on slot machines in 1941. The tax was $10 for devices designed for amusement only, and $50 for gambling machines. The tax was raised to $100 in 1942, $150 in 1950, $250 in 1951.

The Gambling Device Stamp Tax Act was partially gutted by decisions of the United States Supreme Court in 1968 and was repealed by an Act of Congress on November 6, 1978, effective July 1, 1980.

Even before the law was thrown out it was virtually useless. The tax originally applied only to "coin-operated gaming devices," limiting the law to traditional slot machines that operate by the insertion of a coin. Amusement devices were exempted from the gambling tax. Gambling pinball machines, where a player rolled balls in an attempt to line up a winning combination on a bingo card layout, were taxed only if an IRS agent happened to observe an actual payoff being made, which did not happen very often. These loopholes were eventually closed, but the damage to the law was irreversible.

In 1952 Congress enacted the Wagering Tax Act, which imposed a 10 percent excise tax on any wager made in the United States and required anyone engaged in the business of accepting wagers to register and pay a special occupational tax of $50 per year. Gambling operators were required to keep a daily record showing the gross amount of bets taken, and the Act allowed inspection of the bet-taker's books "as frequently as may be needful to the enforcement" of this law. Payment of the federal tax did not prevent the states from imposing their own, additional taxes.

The Wagering Tax Act had two exemptions: licensed parimutuels and coin-operated devices; the first because the government was using its tax power to go after illegal gamblers and the second because the federal Gaming Device Stamp Tax was supposed to have already taken care of illegal machines.

The estimates of the possible revenue to be gained by taxing the gamblers have been wildly optimistic. At the time the wagering taxes were enacted in 1952 it was estimated the IRS would collect at least $400 million annually in additional revenue. The actual results were about one-tenth that amount.

The U.S. Supreme Court declared the Wagering Tax Act constitutional as a revenue measure in 1953. Fifteen years later the Court changed its mind.

At the height of the Warren Court's expansion on the rights of the criminally accused, it was inevitable that the Court would find the gambling registration requirements unconstitutional.

Despite the 1953 decision, it was clear the Act had been designed not as a revenue measure, but rather to set up illegal gamblers as sitting ducks for prosecution. A suspect was open to a gaming prosecution if he bought his stamp and paid his taxes—or a tax case if he didn't. When it appeared that the Court would not allow the IRS to turn its records over to another arm of the federal government for prosecution, the IRS contacted state and local lawmen instead. A suspect could be handed over on a silver platter, with his own tax reports proving that he was involved in gambling that was illegal under state law.

Justice John Harlan wrote for a 7 to 1 majority that setting up a suspect that way violated the Fifth Amendment right against self-incrimination. Buying a stamp was a sort of forced admission in advance that targets a man for investigation and can be used against him later in court. The convictions of two alleged gambling-tax evaders

were overturned. *Marchetti v. United States*, 390 U.S. 39, *Grosso v. United States*, 390 U.S. 62 (1968).

The most interesting twist to the decision was that Chief Justice Earl Warren dissented; in fact, he was the lone dissenter. The man who is remembered as the architect who built the constitutional structure of rights for criminal defendants had been a District Attorney, who once led a boarding party to shut down floating casinos off Long Beach, California. "Gamblers," Warren wrote in dissent, "necessarily operate furtively in the dark shadows of the underworld. Only by requiring that such individuals come forward . . . can Congress confidently expect that [their betting take] . . . will be subject to the legitimate reach of the tax laws." 390 U.S. at 78 (Warren, J., dissenting).

One fascinating result of the federal gambling taxes has been the disclosure of how widespread illegal gambling has become. In 1967, the year before the stamp tax was repealed, the IRS issued 22,396 stamps, one stamp for each location regardless of the number of devices. Only 1,698 stamps were for locations having legal machines in Nevada. Other states, where the machines were illegal, actually had more gambling locations: Louisiana had 2,298 stamps and Tennessee 2,029. The total number of gambling devices at all locations was 66,720, only one-third of which were legal machines in Nevada.

It is impossible to know how many illegal machines ignored the stamp tax. But the fact that there were 20,000 locations having illegal machines that voluntarily reported their existence to the federal government gives some indication of what is really going on in this country. This was in 1967, prior to the video poker craze and at a time when operators could be turned over to local authorities for violating local gambling laws.

A gambling machine cannot make money being hidden in a back room, they must be kept in the open where the public can see them all of the time. The federal stamp tax showed that local authorities could enforce their laws, when they wished. For while West Virginia had 1,001 locations with illegal gambling devices and South Carolina had 1,597; Maine, Connecticut and New York had none. For whatever reason, local law enforcement was not always enforcing the law.

What is left of the gambling tax laws? A lot. The body of the law, registration and raising revenue, still exists, even though the soul, setting up the gamblers as sitting ducks, has been taken by the Court.

The excise tax on wagers, the occupational tax on gambling establishments, and the registration requirements still exist, in reduced form. They can be found primarily in Sections 4401 to 4424 of the Internal Revenue Code. These taxes on wagers used to be administered exclusively by the Internal Revenue Service. On December 24, 1974, responsibility for enforcement was transferred to the Treasury Department's Bureau of Alcohol, Tobacco and Firearms (ATF).

Following the Supreme Court's decisions in 1968, holding the Fifth Amendment right against self-incrimination applies to wagering taxes, criminal investigations under the wagering tax laws came to a virtual halt, with one major exception. Legal gambling operations continued to file reports and were routinely audited and investigated for skimming. Reporting by illegal operations dropped dramatically; about the only illegal gamblers investigated were those who filed false returns, and those unlucky enough to come to the attention of the ATF by being busted by other agencies for other crimes.

The excise tax on wagers was reduced from ten percent to two percent in 1974. The law was amended again in 1982 to lower the tax on legal bets only to one-quarter of one percent (0.25%), illegal bets are still subject to a two percent (2%) tax. The changes are typical of the way the government manipulates gambling taxes for purposes other than raising revenue. Lowering the tax would allow legal bookmakers to be more competitive with their criminal counterparts, who do not pay the tax. The change also reflects the new respectability of the legal gambling industry; it is a breakthrough of sorts that Congress would care whether legal bookmakers were driven out of business by the tax. Of course, it would have made more sense to eliminate legal gambling from the tax completely, but as a vice legal gambling is going to remain subject to discriminatory tax treatment. A legal bookmaker that passes on the cost of these special taxes will continue to drive bettors to the criminal competition; yet, a legal bookmaker who absorbs the taxes may drive himself out of business.

Gambling operators must file a Form 730, Tax on Wagering, each month with the IRS to pay and report the excise tax on wagers.

Form **730**
(Rev. June 1984)

Department of the Treasury—Internal Revenue Service
Tax on Wagering (Section 4401 of the Internal Revenue Code)

OMB No. 1545-0235
Expires 9-30-86
For IRS Use Only

Your name and address (Please type or print)

Employer identification number

T
FF
FP
I
T

For month of
.... 19 .....

If your business records are not available at the address shown above, enter address where records are maintained

For Paperwork Reduction Act Notice, see back of form.

Under penalties of perjury I declare that I have examined this return and any accompanying certificates and statements, and, to the best of my knowledge and belief, they are true, correct, and complete.

Signature ....

Date Title (Owner, etc.)

ORIGINAL—File this return and your payment with your Internal Revenue Service Center. (See *Where to File* on back.) Include your employer identification or social security number on your check or money order.

1	Gross wagers accepted during month (not including lay-offs)	$
2	Gross amount of lay-off wagers accepted during month	
3	Add lines 1 and 2	$
4(a)	Tax on wagers authorized under the law of the state in which accepted (.0025 of such amounts in line 3)	$
(b)	Tax on wagers, other than wagers described on line 4(a) (.02 of such amounts in line 3)	
5	Lay-off credits (No credit allowed unless supported by evidence.)	(–)
6	Net tax due (Subtract line 5 from line 4.)	$

The excise tax is based on the total amount bet, including all charges. This is similar

to a sales tax. If the gambling establishment wishes to, it can collect the two percent or one-quarter of one percent separately.

Only people "engaged in the business of accepting wagers" are liable for the tax, never the bettor. The tax applies to wagers accepted in the United States. Employees are not liable, but only if they register with the IRS. See Form 11-C in this chapter.

Not every gambling operator has to pay this tax. Exempted by statute are licensed parimutuels, state lotteries, and coin-operated or similiar devices. This last exception is a carry-over from the defunct Gaming Device Stamp Tax, and has been kept in the law, for some reason. A bar with video slot machines would be exempt from the excise tax because of this anachronism.

Other operators are also exempt. The definition of "wagers" is very limited. A wager means a bet on a sports event or contest, but only if the bet is placed with "a person engaged in the business of accepting such wagers," in other words a bookie. A wager can also be a bet placed in a sports pool, but only if the pool is conducted for profit. These laws were meant to exempt bets between friends and office pools.

A bet on a lottery conducted for profit is also a wager, but lottery is also carefully defined. A lottery includes the numbers game, policy, and similar types of wagering. Charity raffles are excluded. But also explicitly excluded is "any game of a type in which usually (i) the wagers are placed, (ii) the winners are determined, and (iii) the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game." This is Congress's way of saying there is no excise tax on poker and craps.

The courts have held that gambling pinball machines and punchboards are lotteries conducted for profit. Casual operators are subject to the tax, even if the individual is only incidentally engaged in accepting bets.

The Supreme Court had no trouble finding the government had the power to tax an activity that was illegal. As a small compensation, the Court found the illegal operators were entitled to business tax breaks, including deducting the federal excise tax as an ordinary and necessary business expense.

The law requires each person liable for the excise tax to keep a daily record showing the gross amount of all wagers. The IRS has expanded that requirement to include just about every document created by a gambling game, declaring,

> "Credit play memorandum often referred to as a serialized record, rim card, pit card, table card, or master card containing the necessary data and the signatures of the individuals giving the credit, individual game records such as count cards, game sheets, shift sheets, stiff sheets, and shift summaries, credit slips showing amount due gaming table, fill slips showing amounts furnished gaming table, daily customer's I.O.U. records, individual credit records often referred to as credit card, credit documents of any type prepared by cashiers to record advance of cash or chips to players in return for I.O.U.'s or checks,

and slot machine records including gross receipts, jackpot payouts, reel strip settings, and meter readings for each machine, all constitute records for tax purposes and must be retained as long as material in tax determination." Rev. Rul. 72-554.

If the gambling operator does not pay the various taxes there are all sorts of criminal penalties, as you would imagine. In those rare instances when an illegal operation is busted the IRS can start a civil action to collect back taxes, which can be an additional extremely costly penalty. But how does the IRS determine how much to collect, assuming the bookie doesn't file a form?

In one case a bookie failed to file his returns. The court held the IRS could determine the tax using previous years returns. That is an easy case. The more difficult case, where there are no previous returns, and the bookie does not keep records, the IRS is allowed to use any reasonable method to reconstruct the action. The burden is then on the taxpayer to try and disprove the IRS.

One taxpayer won his suit for a refund when he testified that, although he kept no records, he did keep the wagers he accepted separate from other money. He swore he took in about $100 per day. When the court opened the paper sack that had been seized by the FBI on the day of the raid the judge found $101 in cash.

A completely separate occupational tax is imposed on anyone liable for the excise tax. The occupational tax was raised from $50 to $500 per year in 1974, but was lowered again to $50 for legal operators and their employees. Illegal gambling operators, and their employees, still have to pay $500 per year. If you qualify, you must file a Form 11-C, and pay the occupational and excise taxes due.

You are required to give the IRS your name and residence. In addition, if you are the boss, you must report each place of business where the gambling takes place, and the name and residence of each person who is engaged in receiving wagers on your behalf. If you are the employee, you must turn over the name and residence of your boss. Companies must report the names and addresses of its individuals. The IRS is free to require additional information. It is a felony to make a false statement to any federal agency.

It is important for everyone associated with a gambling business that accepts wagers (under the definition of "wagers") to register and pay the occupational tax. This includes employees who deal with the public.

The penalties for non-registration can be severe. Willful refusal to pay is a crime. An employee who is required to register and does not do so is liable for the excise tax on all bets he takes in for his boss. For the boss, non-registration can result in forfeiture of all cash used in the business as well as all other business property. One bookie was able to save his new Cadillac El Dorado only by registering at the last minute.

Form **11-C**
(Rev. March 1984)
Department of the Treasury
Internal Revenue Service

Special Tax Return and Application for Registry—Wagering

Return for period from .... 19 ..... to June 30, 19 .....
(Month, day, and year)

OMB No 1545-0236
Expires 3-31-87

Use IRS label. Otherwise please print or type.

Name

Number and street

City, county, state, and ZIP code

Social security number

Employer identification number (See instruction 1)

Check one: ☐ First return and application ☐ Renewal return and application
☐ Supplemental return and application

Business address

Alias, style, or trade name, if any

For Internal Revenue Use Only

Stamp number ▶
Date issued ▶

T $		1
FF		2
FP		3
I		4
T $		5

Compute tax as explained in instruction 4, and enter amount due here ▶ $

Make check or money order payable to the Internal Revenue Service for the amount of tax due and remit with return

1 If this is a supplemental application, please explain and give your special tax stamp number and employer identification number. (See instruction 2(b).) ▶ ....

If additional space is required for items 2, 3(a), 3(c), or 4, attach additional sheets identifying each entry as to item number.

2 If taxpayer is a firm, partnership, or corporation, give true name of members or officers.

True name	Title	Home address	Social security number

3 Are you or will you be engaged in the business of accepting wagers on your own account? ☐ Yes ☐ No
If "Yes," complete (a), (b), and (c) of this item.

(a) Name and address where each such business is or will be conducted.

Name of location	Address (Number and street)	City, state, and ZIP code

(b) Number of employees and/or agents engaged in receiving wagers on your behalf ▶ ....

(c) True name, special stamp number, address, and social security number of each such person.

True name	Special stamp no	Address	Social security number

4 Do you receive or will you be receiving wagers on behalf of or as agent for some other person or persons? ☐ Yes ☐ No
If "Yes," give true name, address, and social security number of each such person.

True name	Address	Social security number

Signature and Verification

Under penalties of perjury, I declare that this return and/or application (including any accompanying statements or lists) has been examined by me and to the best of my knowledge and belief is true, correct, and complete.

Signature ▶ Title (Owner, etc.) ▶ Date ▶

For Paperwork Reduction Act Notice, see back of form. Form **11-C** (Rev. 3-84)

Instructions

(Section references are to the Internal Revenue Code unless otherwise noted.)

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

1. Who Must File.—If you are liable for the excise tax imposed by section 4401, or if you are engaged in receiving wagers for or on behalf of any person so liable, you are subject to a special tax of $500 per year imposed by section 4411, and must file Form 11-C. The rate is $50 per year only if all wagers are authorized under the law of the state in which accepted.

In addition, you must file **Form 730**, Tax on Wagering, each month to pay and report the tax on wagers.

Section 4421 defines the term "wager" to mean (1) any wager with respect to a sports event or a contest placed with a person engaged in the business of accepting such wagers, (2) any wager placed in a wagering pool with respect to a sports event or a contest, if such pool is conducted for profit, and (3) any wager placed in a lottery conducted for profit.

The term "lottery" includes the numbers game, policy, punchboards, and similar types of wagering. The term does not include (A) any game of a type in which usually (1) the wagers are placed, (2) the winners are determined, and (3) the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game, and (B) any drawing conducted by an organization exempt from tax under sections 501 and 521, if no part of the net proceeds derived from such drawing inures to the benefit of any private shareholder or individual.

If you are required to file Form 11-C and have not applied for an employer identification number, please complete **Form SS-4**, Application for Employer Identification Number, and attach it to your return when you file. If you have applied for a number but have not received notice of it by the time you must file, please write "Number applied for" in the block on the form for the number.

2. When to File.—

(a) First and Renewal Returns and Applications for Registry.—Form 11-C serves two purposes: (A) a special tax return and (B) an application for registry. You must file the first return and application for registry before engaging in the activity in which you become liable for the special tax on wagering. You must file renewal returns and applications by July 1 of each year thereafter during which taxable activity continues. Changes in ownership which require a return and application for registry, and which result in special tax liability, include the following:

(1) Admission of new members to a firm or partnership.

(2) Formation of a corporation to continue the business of a partnership.

(3) Continuance of the corporate business by a stockholder after the corporation is dissolved.

(b) Supplemental Applications for Registry.—If you have a change of place of business or residence address, you must be registered by filing a Form 11-C, checking the block designated "Supplemental return and application," and giving the new address and the date of change before (1) you engage in any wagering activity at the new address, or (2) the termination of a 30-day period which begins on the day after the date of such change, whichever occurs first.

Any other change must also be registered within 30 days after such change. Examples of other changes include the following: (1) continuance of the operation of a business of a deceased person, who has paid the special tax, by the surviving spouse or child, or executor or administrator, or other legal representative, (2) continuance of a business by a receiver or trustee in bankruptcy, (3) continuance of a business by an assignee for the benefit of creditors, (4) withdrawal from a firm or partnership of one or more members, and (5) mere change of corporate name. Failure to comply with these requirements will result in additional tax and penalty. **The taxpayer's special tax stamp must accompany such supplemental application for proper notation.**

Not later than 10 days after engaging a new agent or employee to receive wagers, an individual accepting wagers on his or her own account shall register the name, number appearing on the special tax stamp, address, and social security number of each such agent or employee by filing a Form 11-C designated "Supplemental Return." Likewise, an agent or employee receiving wagers on behalf of another must register the name, address, and social security number of each additional person by whom he or she is engaged to receive wagers within 10 days after being so engaged.

3(a). Where to File.—

If your principal business, office or agency, or legal residence in the case of an individual, is located in	Send your return to Internal Revenue Service Center at this address
New Jersey, New York City and counties of Nassau, Rockland, Suffolk, and Westchester	Holtsville, NY 00501
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Delaware, District of Columbia, Maryland, Pennsylvania	Philadelphia, PA 19255
Alabama, Florida, Georgia, Mississippi, South Carolina	Atlanta, GA 31101
Michigan, Ohio	Cincinnati, OH 45999
Arkansas, Kansas, Louisiana, New Mexico, Oklahoma, Texas	Austin, TX 73301
Alaska, Arizona, Colorado, Idaho, Minnesota, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201
Illinois, Iowa, Missouri, Wisconsin	Kansas City, MO 64999
California, Hawaii	Fresno, CA 93888
Indiana, Kentucky, North Carolina, Tennessee, Virginia, West Virginia	Memphis, TN 37501

☆ U.S. Government Printing Office: 1984—421-106/200

If you have no legal residence, principal place of business or principal office or agency in any Internal Revenue district, file your return with the Internal Revenue Service Center, Philadelphia, PA 19255.

(b) Hand-Carried Returns.—Returns that are filed by hand-carrying (as defined in Regulations section 301.6091-1(c)) shall be filed with the District Director or with any permanent post of duty within that Internal Revenue district.

4. Computation of the Special Tax on Wagering.—Special tax liability is computed from July 1 of each year, or the first day of the month during which you began the business, to the following June 30. For a renewal or for a business begun during July, the tax is $500. If you begin business after the month of July, compute the tax to be remitted by multiplying the monthly rate of $41.66⅔ by the number of months remaining in the fiscal year. Example: If you began the business in November, compute liability as follows: $41.66⅔ X 8 (the number of months remaining in the fiscal year) equals $333.33, the amount to be remitted. Enter the amount of tax in the designated block on the return. Since the tax is only $50 when wagering is authorized under state law, use 10% of the above figures to illustrate the liability.

5. Penalties.—If you do not file the return before engaging in the activity in which you become liable for the occupational tax on wagering, you may incur the penalties prescribed by sections 6651 and 6653. In addition, under the provisions of section 7262, if you perform any act that makes you liable for the special tax, without having paid such tax, you will incur a fine of not less than $1,000 and not more than $5,000. For willful failure to file a return or pay the tax, the penalties under sections 7201 and 7203 may be imposed. For making and subscribing a false return, statement or other document under the penalties of perjury, or aiding or advising the preparation of such returns, statements or other documents, the penalties under sections 7206(1) and 7206(2) may be imposed.

Under section 1001 of Title 18, U.S.C., whoever knowingly makes any false or fictitious statement with respect to the payment of the special tax, such as the giving of a false name or address, shall be fined not more than $10,000 or imprisoned not more than 5 years, or both.

6. Disclosure of Wagering Tax Information.—No Treasury Department official or employee may disclose, except in connection with the administration or enforcement of Internal Revenue taxes, any document or record supplied by a taxpayer in connection with such taxes, or any information obtained through any such documents or records. Additionally, certain documents related to wagering taxes, and information obtained through such documents, may not be used against the taxpayer in any criminal proceeding, except in connection with the administration or enforcement of Internal Revenue taxes. See section 4424 for more detailed information.

It does not matter if you only accept bets a few months out of the year, you are liable for the full $500 or $50.

Since state lotteries are exempt from the excise tax they are also exempt from the occupational tax. The IRS has ruled that a store that has a coin-operated vending machine to sell state lottery tickets does not have to register. Neither does an OTB outlet.

There are still Fifth Amendment problems with this tax. The Fifth Amendment right against self-incrimination applies to criminal proceedings; you have the right to refuse to make a statement to the government if those statements can be used against you in a criminal action. However, two federal courts have ruled that civil actions to collect the tax do not fall under the constitutional protection. You cannot claim fear of criminal prosecution as an excuse for failing to register.

Registering and paying the tax does not protect you from local anti-gambling laws; in fact, in at least one case, it can have the opposite effect. The Supreme Court of Tennessee upheld a city ordinance that made it unlawful to possess a federal wager stamp. Of course, the Supreme Court knocked out the provision in the tax Code that required the IRS to open its records to local law enforcement to see who has registered.

The IRS can inspect the books of any person liable for the gambling taxes as frequently as "may be needful." Disclosure of the wagering tax information discovered is now strictly forbidden. No employee of the Treasury Department "may divulge or make known in any manner whatever to any person" any of the following: any tax return, payment or registration; any record examined by the government; any information derived from any of these documents. Of course, the government can use this information to prosecute for failing to register or pay the taxes themselves. Other than for that limited use, the information obtained from these wagering taxes cannot be used in any criminal proceedings against that taxpayer.

The law can work to the benefit of the gambler. In a recent case the FBI had independently discovered betting slips and other records of a gambling operation, without any assistance from the Treasury Department. The court suppressed the records, even though the tax Code on its face only applies to documents turned over to the IRS. The court stated that the self-incrimination privilege of the Fifth Amendment does not allow the government to compel a bookmaker to prepare and maintain records showing his gross wages under penalty of prosecution for failure to maintain them, and then to use those same wagering records to convict him of illegal gambling.

Of the two functions of the tax laws, control and revenue, the government's interest in gambling operations is clearly primarily one of control. The opposite is true when the government looks to the other side of the gambling tables. The IRS's main interest in players is to capture part of their winnings.

The government does this through two main weapons: withholding and reporting. By requiring state lotteries and race tracks to withhold 20% before a big winner is

paid, the government can be sure of getting at least that amount in taxes. In all cases where winnings are withheld, and in other big winnings, for bingo, keno and slot machines for example, a tax report has to filed by the gambling establishment with the IRS. The report gives the IRS the information necessary to find the big winner should he decide not to pay the taxes due.

Gambling winnings are considered income and are taxed at the same high tax rate as salaries and interest income. Taxing winnings reflects a deep, abiding American philosophy: people should not get something for nothing. From the Puritan days to the present, gambling is seen as inherently dangerous because it encourages the idea that an individual can succeed without work. Even tax reformers have rebelled at the thought of the government aiding the ne'er-do-well by giving him a tax break, while working men and women have to not only support their families but the government as well.

Gambling losses are another matter. The government feels that since people should not be gambling at all it does not have to give the players any tax breaks. It would be impossible to tax only winnings and not allow any deduction for losses; that would mean each time you won a hand at blackjack you would have to report it as income, even if you lost the next hand for the same amount. The Tax Code allows a player to deduct gambling losses, but only up to the amount won.

Government in the United States has always been somewhat paternalistic toward its citizens. While we proclaim personal liberty we often tell people, by law, what they should do for their own best interest. The Prohibition experiment is the best example. Legal gambling is another. We make gambling legal and then discourage people from playing, through taxes and other disincentives.

State lotteries never pay out million dollar winnings in one bulk sum. Payments are spread out over twenty or more years. This is done in part so the tax burden on the winner will be less. But it is also done to protect the winners from themselves. Winners cannot blow their winnings all at once; they are not even allowed to borrow against guaranteed future payments. By statute a lottery winner cannot use future payments as collateral for a loan or sell those rights to another person.

At times the government's policies can be schizophrenic. An extreme example developed in Colorado recently. Jane Mary Annabelle Castillo, a welfare mother of four, cashed her $459 check for Aid to Families with Dependent Children at a supermarket and bought five $1 lottery tickets. She won $10,000, which she immediately spent on an overpriced, broken down car, TVs, a stereo and restaurant dinners. In a week the money was gone. She failed to tell the welfare office of her big win, but they found out nonetheless. As a result her welfare payments were cut off for 13 months; Castillo and her young children lost their only means of support.

Whether you feel that a woman born and raised on welfare should be gambling with her children's food money is beside the point; Mrs. Castillo was doing exactly

what the state of Colorado told her she should do. The state lottery actively promotes gambling; the advertisements did not tell her that whatever she won in the lottery she would lose in welfare.

Other countries, such as Canada, have found it easier to separate their economic policies from their ideologies. American lotteries mislead the players; it costs the lotteries less than $400,000 to buy an annuity for a 20-year "$1 million" winner. Canadian lotteries pay what they say they are paying, in one lump sum. And Canada does not tax lottery winnings. This encourages people to play the legal games over the illegal ones.

These are the only special federal taxes on gambling. The various state and local governments are free to impose their own taxes. Where gambling is legal, government has rushed in. And, as I showed before, sin taxes are the easiest taxes to impose and to raise.

Casinos in Nevada pay an enormous amount in different taxes. When casino gambling was legalized in 1931 the power to tax and license was given to the counties. Poker was taxed at $25 per month per table, craps and blackjack at $50, slot machines at $10 each.

In 1945 the state imposed a Quarterly State License Fee based on gross gaming revenue. This tax has been raised over the years from one percent to the current rate of three percent on gross gaming revenue under $600,000 per year to five and three-quarters percent on the big casinos winnings.

In 1949 the Nevada Legislature assessed an Annual State License Fee based on the number of games operated by an establishment. Again, the rates went up over the years. Today a casino with one game pays $100 per year, a casino with 17 or more games pays $16,000 plus $200 for each game over 16.

Other taxes followed. The slot machine license fee came in 1967: $35 per quarter per machine for small operators, $20 for larger ones. In addition 1967 saw the introduction of a Quarterly State License fee based on the number of games: one game pays $12.50 per quarter, 36 games pays $20,000 per quarter, plus $25 for each game over 35.

A state Casino Entertainment Tax was instituted in 1965 at five percent and later raised to ten percent. Small casinos are exempt, but the rest have to fork over ten percent on all sales of merchandise, food and beverages, and admissions while the casino is actually furnishing entertainment.

The one time a tax on gambling was eliminated the casinos still did not get a break. There used to be a federal stamp tax of $250 on each slot machine. The state of Nevada saw that the federal stamp tax was going to be repealed in 1980 so the state set up a new tax to take its place, effective the day the federal tax ended.

Race wires, providing horse racing information, are charged $10 per day for each race book service. Parimutuel wagering is also licensed and taxed.

Even the application fee is going up. Nevada gaming officials have proposed raising the application fee for restricted licenses, slot machines in restaurants, etc., from $50 to $150, and non-restricted licenses, casinos, from $250 to $500. This application fee is actually minimal compared to hundreds of thousands of dollars in investigative costs the Gaming Control Board can run up, costs that the applicant has to pay, even if he never gets his license.

The cities, counties and towns in Nevada are free to impose additional taxes, which they all do.

I have focused on the special taxes imposed on gambling because those taxes are special; they are used to control as much as to raise revenue. Of course, there also are all those taxes every business has to pay: income taxes, property taxes and sales taxes.

Income taxes have proven to be a major concern to the government because it feels, quite rightly, that large amounts of taxable income are not being reported. With legal casinos the problem is skimming. There is little that can be done to stop casino insiders from diverting cash, and doctoring up of documents, except to punish the wrongdoers after the fact.

As to the gamblers themselves, the government knows winners are not going to run forward and give themselves up to the IRS. Can the IRS do anything? It can, and it has, with withholding and reporting requirements. Can the gambler do anything about it? Not much, except there are ways of cutting down on the tax, including taking gambling losses off your taxes. Taxes and the single gambler (or married for that matter) is our next case study.

10

Taking Gambling Losses and Expenses off Your Taxes

In the ABC television show "Lottery!" a U.S. Internal Revenue Service Special Agent accompanies the lottery representative who merrily hands out envelopes filled with multi-million-dollar checks. Although the IRS's presence on the show may be simply a device to keep the plots going (after all, a lottery agent doesn't get to carry a gun, but an IRS agent does), the show greatly underestimates the Government's ingenuity and resources.

Can the IRS have a man stationed in every casino full-time? At every horse and dog track? In every state lottery every day? And since even illegal winnings are taxable, can the IRS be at every big stakes poker game, in every bookie joint, and following every floating crap game? As those unfortunate gamblers now serving time for income tax evasion can testify, the answer is yes: the IRS does have a man wherever there is a big winner. The "man" is the gambling establishment itself.

Nobody likes it very much but the law makes the gambling establishment into an enforcement arm of the IRS. And the operator of an illegal game, who naturally enough will not report to the IRS when one of his players wins big, can find himself investigated by the FBI and subject to federal prosecution.

The IRS requires that a form be filed when a gambling establishment withholds gambling winnings so the government will know who the player is to collect any additional taxes owed.

Form W-2G, "Statement for Certain Gambling Winnings," is a four-part form that lets the IRS know of certain big winners. Copy A of the form is sent to the IRS; Copy B is given to the winner to file with his federal tax return if the 20% tax has been withheld; Copy C is for the winner's records; and Copy D is kept by the gambling establishment.

The Internal Revenue Code requires that everyone, from individuals and corporations to states and the federal government, must withhold 20%, in certain cases, before

☐ 3232 For Official Use Only

Type or machine print PAYER'S name

Street address

City, State, and ZIP code

Federal identifying number

1 Gross winnings | 2 Federal income tax withheld

3 Type of wager | 4 Date won

5 Transaction | 6 Race

7 Winnings from identical wagers | 8 Cashier

OMB No 1545-0238

1984

Statement for Recipients of **Certain Gambling Winnings**

Type or machine print WINNER'S name (first, middle, last)

Street address

City, State, and ZIP code

9 Winner's taxpayer identifying number | 10 Window

11 First I.D

12 Second I.D

For Paperwork Reduction Act Notice and instructions for completing this form, see Form W-3G.

Under penalties of perjury, I declare that to the best of my knowledge and belief the name, address, and taxpayer identifying number which I have furnished correctly identify me as the recipient of this payment, and any payments from identical wagers, and that no other person is entitled to any portion of these payments.

Signature ▶ **Date ▶**

Copy A
For Internal Revenue Service Center

Form **W-2G** Department of the Treasury - Internal Revenue Service

Notice to Persons Receiving Gambling Winnings

If you receive:

(a) $600 or more in gambling winnings from

1. Horse racing, dog racing, or jai alai and the winnings are at least 300 times the amount of the wager; or

2. Lotteries, raffles, or drawings (such as those held by churches, civic organizations, etc.) without regard to odds limitations, and other wagering transactions not specifically referred to in (a)(1), (b), or (c);

(b) $1,200 or more of gambling winnings from bingo or slot machines; or

(c) $1,500 or more of proceeds (the amount of winnings less the amount of the wager) from keno;

the payer must report the winnings on Form W-2G.

If you receive proceeds (the amount of winnings less the amount of the wager) of:

(a) More than $5,000 from a State lottery;

(b) More than $1,000 from a lottery (other than a State lottery), wagering pool or sweepstakes; or

(c) More than $1,000 from a horse race, dog race, jai alai or other wagering transaction (other than a lottery, sweepstakes, or wagering pool) with proceeds at least 300 times the amount of the wager;

the winnings are subject to Federal income tax withholding and the payer must withhold twenty percent of the proceeds. Also, for this purpose you are treated as being entitled to any winnings from identical wagers in your behalf that are not part of the payment for which this return is being made, whether or not those other wagers have yet to be paid. In addition, you must sign Form W-2G if you are the only person entitled to the winnings. Winnings from keno, bingo, or slot machines are not subject to withholding.

If any person other than you is entitled to a share of the winnings, you must fill out **Form 5754,** Statement by Person(s) Receiving Gambling Winnings, listing the name, address, identifying number, amount of winnings, and additional winnings from any identical wagers of all persons entitled to any portion of the winnings. In addition, if the winnings (including the winnings from identical wagers) are subject to Federal income tax withholding, you must then sign the form and return it to the payer, who will use it to prepare Form W-2G for each of the winners.

1 Form **1042S** Department of the Treasury Internal Revenue Service

Income Subject to Withholding Under Chapter 3, Internal Revenue Code

1984

OMB No. 1545-0096

Copy A for Internal Revenue Service

Line	(a) Income code	(b) Gross income paid	(c) Tax rate (%)	(d) Exemption code	(e) Tax withheld	(f) Tax released	(g) Net tax withheld (column (e) less (f))	(h) Country code
1								
2								
3								
4	Total							

5 Recipient code (see instructions) ▶

6 Recipient's U.S. tax identification no. ▶

7 Recipient's country of legal residence ▶

8 RECIPIENT'S name, street address, city, province, country, and postal zone

9 Payer's name, address, ZIP code, and EIN (if different from withholding agent's)

10 WITHHOLDING AGENT'S name, address, ZIP code, and employer identification no. (EIN) (as shown on Form 1042)

For Paperwork Reduction Act Notice, see back of Form 1042.

Form **1042**
Department of the Treasury
Internal Revenue Service

U.S. Annual Return of Income Tax To Be Paid at Source (Under Chapter 3, Internal Revenue Code)

1984

Name of withholding agent

Address (number and street)

City, state, and ZIP code

Employer identification number of withholding agent

Part I Record of Federal Tax Deposits

Deposit period ending		Tax liability for period	Amount deposited	Date of deposit	Deposit period ending		Tax liability for period	Amount deposited	Date of deposit
Jan.	7				July	7			
	15					15			
	22					22			
	31					31			
1 Jan. total					7 July total				
Feb.	7				Aug	7			
	15					15			
	22					22			
	29					31			
2 Feb. total					8 Aug total				
Mar.	7				Sept	7			
	15					15			
	22					22			
	31					30			
3 Mar total					9 Sept total				
Apr.	7				Oct	7			
	15					15			
	22					22			
	30					31			
4 Apr total					10 Oct total				
May	7				Nov	7			
	15					15			
	22					22			
	31					30			
5 May total					11 Nov total				
June	7				Dec.	7			
	15					15			
	22					22			
	30					31			
6 June total					12 Dec total				

13 Add lines 1 through 12

14 Final deposit made for year (Enter zero if final deposit is included in line 12.)

15 Total deposits for year (add lines 13 and 14) Enter here and on line 19 below

Part II Due or Overpayment

16 Form(s) 1042S **16a** Number filed on magnetic tape .... **16b** Number filed on paper ....

16c Gross income paid $ .... **16d** Tax withheld ▶

17 Form(s) 1000 **17a** Gross amount paid $ .... **17b** Tax assumed ▶

18 Add lines 16d and 17b

19 Total paid by Federal tax deposit coupons for 1984 (from line 15 above)

20 Enter overpayment applied as a credit from 1983 Form 1042

21 **Total payments.** Add lines 19 and 20

22 If line 18 is larger than line 21, enter BALANCE DUE here (If $200 or more, use FTD coupon.)

23 If line 21 is larger than line 18, enter OVERPAYMENT here

24 Apply overpayment on line 23 to (check one) ☐ Credit on 1985 Form 1042, or ☐ Refund

25 If you expect this to be your final return, write "Final Return" here ▶

Please Sign Here

Under penalties of perjury I declare that I have examined this return including accompanying schedules and statements and to the best of my knowledge and belief it is true correct and complete. Declaration of preparer (other than withholding agent) is based on all information of which preparer has any knowledge.

▶ Your signature | Date | ▶ Capacity in which acting

Paid Preparer's Use Only

Preparer's signature ▶ | Date | Check if self employed ▶ ☐ | Preparer's social security no

Firm's name (or yours, if self employed) and address ▶ | E.I. No ▶ | ZIP code ▶

For Paperwork Reduction Act Notice, see back of form.

Form **1042** (1984)

General Instructions

(Section references are to the Internal Revenue Code, unless otherwise noted.)

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Changes You Should Note

Repeal of 30% Withholding on Portfolio Interest.—Generally, for obligations issued after July 18, 1984, no withholding is required on interest paid on portfolio debt investments to nonresident aliens, foreign partnerships, or foreign corporations.

For interest on a registered obligation not targeted to foreign markets to qualify as portfolio interest and not be subject to 30% withholding, you must receive from the beneficial owner of the obligation a **Form W-8**, Certificate of Foreign Status, or a similar substitute statement; or you must receive a statement from a securities clearing organization, bank, or other financial institution that holds customers securities in the ordinary course of its trade or business that the institution has received a Form W-8 or substitute form. A copy of Form W-8 or substitute must be attached to the statement.

Even though the portfolio interest on a registered obligation not targeted to foreign markets is not subject to 30% withholding, you must prepare a Form 1042S to report the interest payment. Attach the Form W-8 or substitute you received to Form 1042S.

You need not receive a Form W-8 or substitute statement for registered obligations targeted to foreign markets if the interest is paid by a U.S. person to a registered owner that is a financial institution at an address outside the U.S. You may treat the interest on such obligations as portfolio interest not subject to 30% withholding if you do not have actual knowledge that the beneficial owner is a U.S. person and you receive the required certification from the financial institution for each interest payment. (See Temporary Regulations section 35a.9999-5, A-12.) Do not file Form 1042S to report interest not subject to withholding on registered obligations targeted to foreign markets when a Form W-8 is not required.

You need not receive Form W-8 or substitute for bearer obligations targeted to foreign markets. Treat the interest on a bearer obligation as portfolio interest not subject to 30% withholding if the obligation is considered targeted to foreign markets. Do not file Form 1042S to report interest not subject to withholding on bearer obligations when a Form W-8 is not required.

United States Withholding Agents

Purpose of Form.—Use Form 1042 to report withheld tax and to transmit **Forms 1042S,** Income Subject to Withholding Under Chapter 3, Internal Revenue Code.

Who Must File.—Form 1042 must be filed by all individuals, corporations, and partnerships, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of interest, dividends, rents, royalties, annuities, salaries, wages, premiums, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical income, gains described in section 402(a)(2), 403(a)(2), or 631(b) or (c), amounts subject to tax under section 871(a)(1)(C) or 881(a)(3), gains subject to tax under section 871(a)(1)(D) or 881(a)(4), and gains on transfers described in section 1235 made before October 5, 1966, to the extent such items constitute gross income from sources within the United States (see sections 638 and 861 through 864) of nonresident alien individuals, foreign partnerships, or foreign corporations.

Also file Form 1042 if you pay gross investment income to foreign private foundations that are subject to the tax imposed by section 4948(a).

The payers of such income are required to withhold and deduct a tax therefrom at the rate in effect when the payment is made.

You do not have to withhold tax on any of the above income (other than compensation for personal services) if the income is (1) effectively connected with the conduct of a trade or business in the United States, (2) includible in the recipient's gross income for the tax year under section 871(b)(2), 842, or 882(a)(2), and (3) the recipient has filed, in duplicate, **Form 4224** or a written statement giving the same information shown on Form 4224. The copy of the form or statement must be attached to the appropriate Form 1042S required for the calendar year.

You must file this return whether or not any tax was withheld or was required to be withheld if you are required to file Form 1042S. Form 1042S must be filed to report all items of income described above, except income that is required to be reported on Form W-2.

The tax paid at the source upon tax-free covenant bond interest payable to a domestic or resident fiduciary and allocable to any nonresident alien beneficiary under section 652 or 662 is allowable, pro rata, as a credit against the tax required to be withheld by the fiduciary from the income of the beneficiary.

Additional Information.—For more information, see **Publication 515,** Withholding of Tax on Nonresident Aliens and Foreign Corporations.

Form 941.—Use Form 941, Employer's Quarterly Federal Tax Return, to report wages paid to a nonresident alien employee that are subject to withholding under section 3402.

Forms You Must Send With Form 1042.—You must send Copy A of all Forms 1042S when you file Form 1042, even if income is exempt from tax withholding.

Note: *File a copy of Form 1001 with Form 1042S (Form 1042 if Form 1042S filed on magnetic tape) if the recipient of income is claiming treaty benefits and the recipient's address on Form 1042S is not in the country shown in column (h) and on line 7, Form 1042S. Also attach a copy of Form 4224 or any other certificate, statement, letter, or form relating to exemption from withholding as described in Regulations section 1.1441-4 to Form 1042S.*

Where and When to File.—File Form 1042, along with Forms 1042S, 1001, if required, and 4224 with the Internal Revenue Service Center, Philadelphia, PA 19255, by March 15, 1985. If any tax due for the calendar year is less than $200, pay it in full with this return. Make your check or money order payable to the Internal Revenue Service.

Magnetic Tape Reporting.—You may use magnetic tape to furnish information required by Form 1042S. To do so, see Rev. Procs. 83-3 and 83-65, available from any Internal Revenue Service Center.

Tax Treaties.—Residents of certain foreign countries may be entitled to reduced rates of, or exemptions from, tax under an applicable tax treaty between the country of which they are residents and the United States. The procedures recipients must follow to establish with you that they qualify for a reduced rate of, or exemption from, tax are discussed in Publication 515.

Amended Return.—You should never file more than one Form 1042 for the same year. However, if you become aware of any changes that should be made to this return, you should file a corrected Form 1042. Report in Parts I and II the corrected amounts and attach the required statements (Form 1042S, etc.) to support the corrections. You should write "Amended" on the top margin of Form 1042.

Deposit Requirements.—Generally, you must deposit the tax withheld and required to be shown on Form 1042 with an authorized financial institution or a Federal Reserve bank or branch using a coupon from the Federal Tax Deposit Coupon Book (**Form 8109**), that IRS sent you. Please follow the instructions provided on that form. Please do not use anyone else's coupons. If you don't have your coupons when a deposit is due, contact your IRS district office. To avoid a penalty, do not mail your deposits directly to the IRS. The following rules explain how often you must make deposits.

- **If at the end of any quarter-monthly period the total amount of undeposited taxes for the year is $2,000 or more,** you must deposit the taxes within 3 banking days after the end of the quarter-monthly period. (A quarter-monthly period ends on the 7th, 15th, 22nd, and last day of the month.) In determining banking days, do not count any local holidays observed by authorized financial institutions, as well as Saturdays, Sundays, and legal holidays. The deposit requirements are considered met if (1) you deposit at least 90% of the actual tax liability for the deposit period, and (2) if the quarter-monthly period is in a month other than December, you deposit any underpayment with your first deposit that is required to be made after the 15th day of the following month. Any underpayment of $200 or more for a quarter-monthly period ending in December must be deposited by January 31.
- **If at the end of any month the total amount of undeposited taxes for the year is $200 or more but less than $2,000,** you must deposit the taxes by the 15th day of the following month. (This does not apply if you made a deposit for a quarter-monthly period during the month under the $2,000 rule explained above.)
- **If at the end of the year the total amount of undeposited taxes is less than $200,** you may either pay the taxes directly to IRS along with your Form 1042 or deposit them by March 15.

Penalty for Overstated Tax Deposits.—If you overstate your deposits, you may be subject to a penalty. See section 6656(b).

Canadian Withholding Agents

If you are a nominee, representative, fiduciary, or partnership in Canada and you receive dividends from sources in the United States for the account of any person who is not entitled to the reduced rate granted under the tax treaty between the United States and Canada, you are a withholding agent and you must withhold the additional tax due on such income.

Send the additional U.S. tax withheld, in U.S. currency, with this return to the Internal Revenue Service Center, Philadelphia, PA 19255, by March 15, 1985.

Specific Instructions

Line 16.—The amount on line 16c should equal the sum of all Forms 1042S, line 4, column (b). If during 1984 you withheld more tax than required, you may release it to the recipient any time before you file Form 1042 for the year. In this case, enter in column (f) of Form 1042S the amount released. Enter the net tax withheld in column (g) of Form 1042S and on line 16d of Form 1042.

The amount on line 16d should equal the sum of all Forms 1042S, line 4, column (g). If it does not, attach a statement explaining the difference.

In determining tax withheld on remuneration for labor or personal services that a nonresident alien performs in the United States, a deduction for personal exemptions, to the extent allowed by section 873(b)(3), is allowed prorated on the basis of $2.74 a day for each exemption for the period during which the alien performs the services in the United States. Attach a statement to applicable Forms 1042S explaining the amount of compensation for labor or personal services in the United States and the amount of exemptions prorated.

Lines 23 and 24.—You may claim an overpayment on line 23 as a refund or a credit. Check either box on line 24 to show which you are claiming. If you claim a credit, it can reduce your required deposits of withheld tax for 1985.

Sign and Date Your Return.—Form 1042 is not considered a return unless you sign it.

U.S. GOVERNMENT PRINTING OFFICE: 1984

paying off gambling winnings. The 20% withholding is to ensure that the federal government gets its tax share.

Nonresident aliens and foreign corporations were exempted from the 20% withholding, because they are subjected to another, worse, 30% withholding. The gambling house will give the nonresident alien winner a copy of a completed Form 1042S. The house then sends a copy of the Form 1042S along with an Annual Return Form 1042 to the IRS. The IRS gives the nonresident alien what it considers a break: if too much was withheld the alien does not have to file a tax return. Since 30% is an enormous amount of taxes, in most cases the alien should file a Form 1040NR to get back part of the winnings that were withheld.

There may in addition be withholding to pay for state income taxes. State taxes are much smaller than the federal income tax and the amount withheld should also be less. Since state tax law tends to follow federal tax law I will limit the discussion and examples here to the federal tax. But be aware that those state taxes also exist.

Not all forms of gambling are subject to withholding.

The federal withholding law applies to state lotteries as well as privately owned games; however, withholding only applies to the following winnings: 1) all state lottery "proceeds" of more than $5,000; 2) sweepstakes, wagering pools, or lotteries (other than state lotteries) proceeds of over $1,000; 3) horse race, dog race, jai alai or other parimutuel bets or any other wager if the proceeds are over $1,000 and also are at least 300 times the amount bet.

Notice that the statute uses the term "proceeds," not winnings; proceeds are winnings minus the amount bet. So a bet of $1 on a state lottery that wins $5,000 results in proceeds of $4,999 and no money should be withheld for federal taxes. Even if the proceeds were exactly $5,000, no money should be withheld, because the law states the proceeds must be *more than* $5,000. Since ticket prices for state lotteries are small it is safe to say any lottery prize larger than $5,000 will result in 20% being withheld.

For parimutuel bets the proceeds (winnings less the amount bet) must exceed $1,000 and must be at least 300 times the wager; a bet of $5 that wins $1,400 should not have anything withheld for federal taxes.

The requirement to withhold taxes for gambling winnings does not coincide completely with the requirement to report gambling winnings. The biggest difference is with bingo, keno and slot machines.

If you win $1,200 or more from bingo or slot machines, the bingo hall or casino must file a W-2G, reporting your winnings to the IRS. However, nothing can be withheld for federal taxes, no matter how much you win. If you win $1,500 or more in proceeds from keno, the casino must file a W-2G, but again, nothing can be withheld, no matter how much you win. There is no logical reason for putting a $1,200 minimum threshold on bingo and slot machine winnings while making it $1,500 for

keno. The law often consists of drawing lines at points that appear to be arbitrary. The difference in reporting requirements for these games is probably just a historical accident.

In these cases the IRS is obviously trying to find out who the winners are, but Congress has not given it the power to withhold taxes in advance.

Lotteries, raffles, or drawings, such as those held by charities, must report anyone who wins $600 or more, regardless of the odds. This differs from the requirement that there be over $1,000 in proceeds before anything is withheld. If you win a television set worth $900 from the Lions Club you will not have anything withheld, but you will be reported to the IRS. If the prize is less than $600 there is no reporting or withholding. If it is over $1,000, 20% will be taken off the top for the federal government.

The same $600 minimum for reporting and $1,000 minimum for withholding applies to illegal wagers; although, the entire thing is generally ignored by the illegal operators. The withholding and reporting laws apply to illegal bets as well as legal ones, if the proceeds meet the standards. This was obviously designed to attack the illegal numbers games. The withholding law cannot apply to blackjack or crap games, whether legal or illegal, because there is no way to make a bet that gives winnings 300 times the size of the bet. The IRS reporting requirements could possibly apply to craps and blackjack winnings over $600, but no one, including the IRS, has tried to get casinos to report on these games.

The reporting requirements are more complicated for parimutuel bets. Remember, the government withholds 20% of winnings only when the proceeds (winnings less amount bet) are over $1,000 and are at least 300 times the amount bet. Smaller winnings will be reported, although no money will be withheld, under the following rule: a W-2G must be filed if the winnings are $600 or more and are at least 300 times the amount bet.

I have calculated the minimum amount that you must have won for various amounts bet before you are subject to withholding or reporting to the IRS. The calculations are to the penny using the language of the Internal Revenue Code. The IRS may round off numbers, but you should not, if it makes a difference in your favor. On a two dollar bet the IRS can only withhold 20% if you have won at least $1,002.01; if you let them withhold for a winning of $1,002.00 you are giving them the free use of $200 out of your pocket. The minimum amounts of winnings that are reported and winnings that are subject to the 20% withholding are listed in Table 1.

In the legal gaming establishment a bingo or slot machine winner of over $1,200 and a keno winner of over $1,500 will be handed a W-2G along with his winnings, even though nothing is withheld. The winner is required to present two types of identification to aid the casino in filling out the form. Since most winners are more than a little reluctant to tell the IRS about their big win the casino is put into a sticky

TABLE 1

Amount Bet	Subject To Withholding If Winnings Are At Least	Subject To Reporting If Winnings Are At Least
$0.50	$1,000.51	$600.00
$1.00	$1,001.01	$600.00
$2.00	$1,002.01	$600.00
$2.01	$1,002.02	$603.00
$3.00	$1,003.01	$900.00
$3.33	$1,003.34	$999.00
$3.34	$1,003.35	$1,002.00
$3.35	$1,008.36	reported because withheld
$3.50	$1,053.51	"
$4.00	$1,204.01	"
$5.00	$1,505.01	"
$6.00	$1,806.01	"
$8.00	$2,408.01	"
$10.00	$3,010.01	"
$20.00	$6,020.01	"
$25.00	$7,525.01	"
$50.00	$15,050.01	"
$100.00	$30,100.01	"

situation: the casino can either get into a fight with the big winner (bad for public relations) or get into a fight with the IRS (bad for staying out of jail).

The Nevada Gaming Control Board recognized "This requirement poses a problem for management when the winning patron does not have or refuses to produce the required two pieces of identification. While the Gaming Control Board does not wish to be the primary means of enforcing the federal regulations, the Board does feel compelled to assist the gaming licensee [casino] with the identification problem." The Board wisely set up a 24 hour, 7 days a week phone number to its Enforcement Division to assist the casinos in dealing with uncooperative winners.

To make sure that the gambling establishment turns in all of its W-2G's, Copy A, the IRS has devised a special form for transmitting W-2G's. It is called a W-3G and contains detailed instructions on how to file and how much to withhold.

The withholdings are treated exactly the same as the withholdings on your salary. The government holds your money, and it is *your* money, not theirs, until you file that year's income tax return. The government does not pay you interest on the money it has withheld, which is an additional bonus for them.

You can file a return and ask for some of the withholdings back, assuming you do not make enough with your entire year's income to justify a 20% tax. You are,

8888

For Official Use Only

[illegible] PAYER'S name	1 PAYER'S identifying number	2 Enter the number of Forms W-2G transmitted	OMB No. 1545-0238 **1984** Transmittal of **Certain Information Returns**
	3 Enter the number of Forms 1099-R transmitted	4 Total Federal income tax withheld	
	5 [illegible]		**Copy for Internal Revenue Service Center**

Under penalties of perjury, I declare that I have examined this return, and accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law in attempting to secure such numbers from the recipients.

Signature ▶ .... Title ▶ .... Date ▶ ....

Form **W-3G**

Department of the Treasury — Internal Revenue Service

Please return this entire page to the Internal Revenue Service Center address for your State as listed below.

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Instructions for Form W-3G

Who Must File.—Payers of gambling winnings for which a **Form W-2G**, Statement for Recipients of Certain Gambling Winnings, is required and payers of certain death benefits or total distributions (those that close the account) from a pension plan, annuity, or individual retirement arrangement for which a **Form 1099-R**, Statement for Recipients of Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, etc., is required, must file Form W-3G, Transmittal of Certain Information Returns, with Forms W-2G or Forms 1099-R.

When to File.—File Forms W-3G with Forms W-2G and 1099-R by February 28 of the calendar year following the calendar year in which payment is made.

Where to File.—(Do not file with the Social Security Administration.)

If your principal business office or agency, or legal residence in the case of an individual, is located in ▼	Use the following Internal Revenue Service Center address ▼
New Jersey, New York City and counties of Nassau, Rockland, Suffolk, and Westchester	1040 Waverly Avenue, Holtsville, NY 11799
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	310 Lowell Street, Andover, MA 01810
Alabama, Florida, Georgia, Mississippi, South Carolina	4800 Buford Highway, Chamblee, GA 30341
Michigan, Ohio	201 West Second Street, Covington, KY 41019
Arkansas, Kansas, Louisiana, New Mexico, Oklahoma, Texas	3651 S. Interregional Highway, Austin, TX 78740
Alaska, Arizona, Colorado, Idaho, Minnesota, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	1160 W. 1200 South Street, Ogden, UT 84404
Illinois, Iowa, Missouri, Wisconsin	2306 E. Bannister Road, Kansas City, MO 64131
California, Hawaii	5045 E. Butler Avenue, Fresno, CA 93727
Indiana, Kentucky, North Carolina, Tennessee, Virginia, West Virginia	3131 Democrat Road, Memphis, TN 38110
Delaware, District of Columbia, Maryland, Pennsylvania	11601 Roosevelt Boulevard, Philadelphia, PA 19154

If you have no legal residence, principal place of business, or principal office or agency in any Internal Revenue district, file your return with the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, PA 19154.

Magnetic Media Reporting.—IRS encourages filing information returns on magnetic tape, diskette, or disk pack. Revenue Procedures for Magnetic Media Reporting are available at Internal Revenue service centers and district offices. Information reported on Forms W-2G and 1099-R may be reported on the same tape or disk submission.

Undeliverable Forms.—Any copies of Form W-2G or Form 1099-R which, after a reasonable effort, cannot be delivered to a winner or recipient should be kept as a part of your records for four years.

Payer's Identifying Number.—Your payer's identifying number is your Employer Identification Number.

Shipping and Mailing.—Payers should group returns of the same type and forward them in separate groups.

Completing the Form.—Enter the number of forms being transmitted in the appropriate box (Box 2 for W-2G, Box 3 for 1099-R). Enter in Box 4 the total Federal income tax withheld on the forms covered by this transmittal.

If you are sending many forms, you may send them in conveniently-sized packages. On each package write your name and identifying number. Number the packages consecutively and place Form W-3G in package number one. At the top of Form W-3G show the number of packages. Postal regulations require forms and packages to be sent by first class mail.

Corrected Returns.—Use a separate Form W-3G for corrected returns and mark over the "X" in the checkbox next to the number in the top left corner of the form. If a Form 1099-R is prepared incorrectly, do not cut and separate the forms on the page. Simply mark over the "X" in the checkbox to the left of the word "VOID" appearing in the top left corner of the form and prepare a new form for those voided. On corrected Forms 1099-R mark over the "X" in the checkbox appearing next to the number in the top left corner of the form. On corrected Forms W-2G center the words "CORRECTED RETURN" in the space at the top of the return above "For Official Use Only" and mark an "X" in the box next to the number in the left corner of the form. For paper forms correcting data previously submitted on magnetic tape, diskette, or disk pack, print "CORRECTED RETURN - MAGNETIC MEDIA" on the bottom of the transmittal Form W-3G and mark the checkbox on the Form W-3G and on each Form W-2G or 1099-R. Complete all required data boxes on a corrected return, since it supersedes the information previously reported. Also, statements issued to recipients or winners should be identified as "CORRECTED."

General Instructions for Payers of Gambling Winnings

Instructions for Form W-2G

Who Must File.—The requirements for filing Form W-2G, Statement for Recipients of Certain Gambling Winnings, depend on the type of gambling and are listed separately following these general instructions.

If a recipient fails to furnish a payer of gambling winnings with a correct taxpayer identification number, a payer is required to withhold 20% of the proceeds and report this amount on Form W-2G. This is referred to as backup withholding. It applies to any gambling situation of reportable winnings for which there are no regular withholding requirements.

(Continued on page 2)

of course, required to file a tax return each year. But you can expect some of the withholding back if too much was withheld. For the 1984 tax year the 20% bracket, for total tax liability, is at about the $41,000 level: a married couple filing a joint return and having a taxable income (line 37 on form 1040) of $41,000 pays $8,195 in taxes, or 19.99%. (This is not the definition of 20% tax bracket usually used by tax advisors. They are more interested in the tax on the next dollar, not your total

Form **5754** (Rev. November 1983) Department of the Treasury Internal Revenue Service

Statement by Person(s) Receiving Gambling Winnings

▶ For instructions for Form 5754, see Form W-3G.
▶ For Paperwork Reduction Act Notice, see back of form.

OMB No. 1545-0239

Date won	Type of winnings	Game number	Machine number	Race number

PART I.— Person to Whom Winnings are Paid

Name	Address

Taxpayer identifying number	Other I.D	Amount received	Federal income tax withheld

PART II.— Persons to Whom Winning Payments are Taxable

Name	Taxpayer identifying number	Address	Amount won	Winnings from identical wagers

Under penalties of perjury, I declare that to the best of my knowledge and belief the names, addresses, and taxpayer identifying numbers which I have furnished correctly identify me as the recipient of this payment and correctly identify each person entitled to any portion of this payment and any payments from identical wages

Signature ▶ Date ▶

Form 5754 (Rev. 11-83) Page 2

PART II.— Persons to Whom Winning Payments are Taxable *(Continued)*

Name	Taxpayer identifying number	Address	Amount won	Winnings from identical wagers

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

In the event that any person other than the person receiving gambling winnings which are subject to withholding or reporting requirements ("recipient") is entitled to a portion of the winnings, this form must be completed by the recipient. If the recipient is not one of the winners, that person must fill in his or her name, address and taxpayer identifying number in Part I and then list in Part II the names, addresses, taxpayer identifying numbers, the amount of the winnings, and the amount of any additional winnings from identical wagers which each of the other persons is entitled to receive. If the recipient is one of the winners, that person's name, the amount of the winnings, and the amount of any additional winnings from identical wagers should also appear in Part II. The taxpayer identifying number for an individual is the social security number; for all others it is the employer identification number. The statement must then be signed (if Federal income tax is withheld) and returned to the payer of the winnings. The payer will file a Form W-2G at the time of the payment or no later than January 31st of the year following the year of the winnings.

This form should be retained by the payer for a period of four years from the date of the payment of the winnings and must be made available to Internal Revenue upon request during that period.

☆U.S. Government Printing Office: 1983—421-108/248

PAYER'S name, address, ZIP code, and Federal identifying number	1 Rents	2 Royalties	OMB No. 1545-0115 **1984** Statement for Recipients of **Miscellaneous Income**
	3 Prizes and awards	4 Federal income tax withheld	
	5 Fishing boat proceeds	6 Medical and health care payments	
RECIPIENT'S name, address, and ZIP code.	Recipient's identifying number	7 Nonemployee compensation	For Paperwork Reduction Act Notice and instructions for completing this form, see Instructions for Form 1096.
	8 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ► ☐		
			Copy C For Payer

Form **1099-MISC** Department of the Treasury · Internal Revenue Service

Instructions for Recipient

Amounts shown on this return are required to be reported to you and to the Internal Revenue Service. They may or may not be taxable to you. If you are an individual, report them on your tax return as explained below. (Other taxpayers such as fiduciaries report the amounts on corresponding lines of your tax return.)

Boxes 1 and 2.—On Schedule E (Form 1040); or Schedule C if you provide services that are primarily for your customer's convenience such as regular cleaning, changing linen, or maid service.

Box 3.—On Schedule C or F (Form 1040) if it is trade or business income to you. If not, report amounts on the line for "Other income" on Form 1040.

Box 4.—Any amount listed in this box represents backup withholding. For example, persons not furnishing their taxpayer identifying number to the payer become subject to backup withholding at a 20% rate on certain payments shown on the form. See **Form W-9**, Payer's Request for Taxpayer Identification Number, for information on backup withholding and the furnishing of your taxpayer identifying number to the payer. You may take a credit on your income tax return for the tax withheld.

Box 5.—An amount in this box means the fishing boat operator considers you self-employed. Report this amount on your Schedule C (Form 1040). See **Publication 595**, Tax Guide for Commercial Fishermen.

Box 6.—On Schedule C (Form 1040).

Box 7.—Generally, these amounts are considered income from self-employment. Report them as part of your trade or business income on Schedule C or F (Form 1040). If you are not self-employed, amounts paid to you for services rendered are generally reported on Form 1040 on the line for Wages, Salaries, Tips, etc.

Box 8.—An entry in the checkbox means sales to you of consumer products on a buy-sell, deposit-commission, or any other basis for resale, have amounted to $5,000 or more. The person filing this return does not have to show a dollar amount in this box. The income should generally be reported on Schedule C (Form 1040).

See **Publication 533**, Self-Employment Tax, for more information on amounts considered self-employment income. Since no income or social security taxes will be withheld by the payer, you may be required to make estimated tax payments. See **Form 1040ES**, Estimated Tax for Individuals.

I.E. #38-2515832

tax. At the $41,000 income level 34% of the next dollar you earned would go for taxes, so they say you are in the 34% tax bracket. I find talking about the total tax liability more useful.)

If you had won less than $40,000 and had no other income, you would get a refund. Even if you had other income, such as a salary that was subject to withholding, if your total income is below $40,000 you should get a refund. However, if your total income is above $40,000, including your big gambling win, you will probably have to pay additional taxes.

Since the federal income tax is a progressive tax, meaning the percentage taken by the government increases with the amount earned, it is possible to lower your taxes by splitting your earnings. If a single man buys a $1 lottery ticket and wins $40,000 he will have to pay the federal government $9,759 in taxes. However, if two single people each put in 50 cents for that same lottery ticket, each would report $20,000 in winnings and pay only $3,212 each in taxes, or a total of $6,424. By splitting the winnings the two have saved $3,335 in taxes. This happens so often that the

IRS has devised a form for the times when one person places the bets for another or for a group.

Form 5754 allows you to receive W-2G forms that properly reflect the amounts won by each individual in the betting pool. On a smaller win, say $5,000 to $10,000 for a state lottery or $1,000 to $2,000 at the track, it should allow you to avoid withholding. Two people going in on a lottery ticket and winning $8,000 results in proceeds of $4,000 to each, below the minimum withholding requirement of $5,000. Two people sharing a winning ticket at the track that paid $1,900 means each person won $950, less than the $1,000 minimum for withholding.

Splitting of winnings can be so significant that even lottery multi-millionaires use it to cut their taxes. The largest winner in American history, Michael E. Wittkowski of Chicago, who won the Illinois state lottery, insisted that the prize be reported as being split among his family members, despite the fact that he had won $40 million. He wanted to recognize that his family had always pooled their bets, to share his new fortune with those who had chipped in to buy the ticket. The resulting tax savings will be in the millions of dollars.

Tournaments are the latest craze to hit casinos and card rooms. Are tournament winnings taxable? Of course. Everything you earn or win is taxable, with rare exceptions, like the Nobel Prize. Will the IRS know that you have won a tournament? They should, because winnings are supposed to be reported by the tournament sponsors.

Tournament winners are specifically covered by Form 1099-MISC, which requires businesses to report on prizes and awards given to nonemployees if over $600. The tournament sponsors are required under IRS regulations to file copies of their 1099-MISC along with a Transmittal Form 1096; although in practice, very few tournament operators actually report winners.

In fact, all gambling winnings are subject to a catch-all "$600 or more" rule in the Internal Revenue Code: every person engaged in a trade of business who pays $600 or more to another person in any taxable year is required to file an information return with the IRS. The law has not been generally applied to casinos. The major problem would be figuring out how much was won and whether the law applies.

Technically, each time a player leaves a table he has finished that game and should report his winnings, even if he is just taking his chips to another table; in fact, since the law covers "wagers" the player should report each bet made. Even the IRS sees this is impossible to enforce, at least with table games in casinos. Even checking at the cashier's does not tell you much; when a player cashes in $5,000 in chips did he win $4,900 or lose $10,000? It is theoretically possible to keep track of each player's winnings and losses for each session, but the IRS has not so far required casinos to do so. (It will be extremely useful for the player to do so, in a diary, so that he can take his gambling losses off his taxes.)

Since it appears clear the IRS will find out about your big win, at least at the track,

bingo, keno or a state lottery, is there anything you can do to cut down on your taxes? One way, as I've shown, is to split winnings. Another way is to take your gambling losses off your taxes.

You can take your gambling losses off your taxes—with two major restrictions:

1) Each year's gambling losses can be deducted only up to the amount of that year's gambling winnings; and

2) You have to prove your losses.

Are these really restrictions? Yes and no. Since you are limited to the amount you won in any year the tax laws obviously hurt you if you have a losing year and don't help you very much if you make a big win. On the other hand, there is nothing that limits the losses you can deduct to any one session, or any one type of game, or even to legal gambling.

All income, including gambling winnings and prizes, is supposed to be reported to the IRS. The proper place to list winnings is as "other income" on line 22 of your 1040 tax return. You are also allowed to take gambling loses off your taxes to the amount of your winnings. Unfortunately, you are not allowed to simply subtract your losses from your winnings and put that amount on line 22. Instead, you can only take off your gambling losses if you itemize your deductions. Gambling losses are an "other miscellaneous deduction" and should be listed on line 22 of Schedule A of Form 1040.

If you win $25,000 over the course of the year and lose $30,000 total, you are supposed to report the $25,000 as part of your gross earnings (line 22 of Form 1040) and then take $25,000 as an itemized deduction (line 22 of Schedule A). The net result is not exactly zero because reporting the winnings affects your limits on deductions for medical and charity expenses. But the important point is that you lost an additional $5,000 that you cannot deduct.

If you "invest" in the stock market instead of "gambling" you will report $25,000 as short term capital gains and then deduct all of the $30,000 as short term capital losses. You may have to carry some of that short term capital loss over to the next tax year, but you can still use the entire amount you lost to reduce your taxes. Such is the equity of the tax laws.

If you have a winning year the situation is a little better but not much. If you win $30,000 over the course of the year and lose $25,000 total, you report the $30,000 as income and then take the $25,000 off as a deduction. The stock market investor is in the same boat, with one extra advantage: if the investor had a big loss from the previous year he could carry the loss forward and take it off his taxes this year; the gambler must treat each year separate and losses not used in any tax year are gone forever.

Say you finally hit it big and pull a Twin Double ticket at the racetrack for $50,000. Assuming you are on a regular calendar year for your tax year, as most people are,

you can deduct all of your gambling losses from that year of your taxable income, up to $50,000. If you win on January 2nd you will have 363 days to accumulate and prove gambling losses.

What do you do if you win big on December 23rd? You could scramble, sweep up losing tickets off the track grounds, get your friends to lie and say they won thousands from you earlier that year, and various other schemes that are not only illegal but universally unsuccessful.

What you should be doing (and what you should have done throughout the year) is keep detailed records and an accurate diary of your winnings and losses every single time you gamble so that you can substantiate your claim that you had lost many times during the previous 11 months.

And remember, you are not limited in the type of gambling loss you can deduct. From your big win at the track you can deduct losses from casinos, home poker games and even illegal sports bets with bookies. The IRS cannot turn this information over to any other prosecutor (and the bet may not have been illegal anyway; sometimes only the bookie is breaking the law, not the player).

Of course, no gambling loss does you any good if you cannot prove it to the IRS or ultimately to a judge. What records and documents do you have to prove your losses?

First, I must make it clear we are talking about losses—not expenses, like transportation and lodging. The IRS is very antagonistic toward taxpayer's who claim to be in the business of gambling, as I'll show later.

What type of records should you keep to prove your losses? The IRS would have you keep books more detailed than a businessman's expense account. For example, for slot machine players the IRS suggests writing down the number of each machine played (and since the numbers are often not posted you are supposed to ask the casino operator for the State Gaming Commission number), the name and location of the gambling establishment, the names of people with you at each session and the winnings by date and time. You are also advised to keep permanent books of accounts or record, and lots of other documents that no gambler usually gets or keeps.

The IRS and the courts are hard on gamblers trying to prove losses. Losing tickets from the track will be checked for scuff marks from being stepped on and will be run through computers to see if the bettor could have really made the bets claimed. The ink in a gambler's notebooks will be checked to verify the dates losing entries were made.

A taxpayer who kept no detailed records found that his quick notebook entries of net gambling winnings were admissible but entries showing net losses were disregarded as "self-serving declarations." Other courts, however, have allowed gambling losses where the gambler kept cancelled checks, ticket stubs and a detailed and accurate record book. One taxpayer was allowed a deduction for all gambling losses in his monthly diary because he had included all racetrack winnings in the

diary, even those that were not reported by the track on the track's withholding forms.

The best way to prove gambling losses is to keep meticulous and accurate records of all gaming sessions with supporting documentation. Keep a diary of your gambling, including place, amount won or loss and bet, and any other information that will substantiate that you actually made the bet. Write your notes during or immediately after each session.

A good poker player or handicapper keeps records like this anyway, why not a player of blackjack, craps or even the slots? Get a big manila envelope and throw in any receipts, money orders, cancelled checks, bank withdrawals, bills, markers or anything else related to the gambling session. Also include documents that prove you were where you say you were: hotel bills, airline tickets, and gasoline credit card slips. You don't have to be neat. And for big losses, get a statement from the pit boss or casino.

The IRS is allowed to prove your income by tracing back your expenditures. This is an expensive process since agents must check every receipt and talk with stores where you shop, etc. You, as a taxpayer, are not allowed to do the same thing; you cannot prove that you lost as much as you won because you have spent so little. You must have documents and a diary to substantiate your losses.

The IRS heard that card expert Oswald Jacoby had won $100,000 in one year playing bridge. This was not reported on Jacoby's Form 1040 so the IRS undertook an investigation of his expenditures to find out how much he had won over the years that had not been reported. Eventually, the IRS charged that Jacoby and his wife had failed to report $270,000 from winning bets on cards, dice, and sports over a five-year period. Jacoby argued in court that he was a compulsive gambler and had lost at least that much. The judge was partially convinced that there had been considerable losses because of the couple's modest standard of living. However, he only allowed $140,000 in losses because Jacoby had kept incomplete records, leaving $130,000 in taxable income.

If you've won big early in the year you obviously have an incentive to get every penny of gambling losses as deductions, especially if 20% of your winnings were withheld. But even if you haven't won yet, isn't it possible that you might win big before the year is out?

Gambling related expenses, as opposed to gambling losses, are deductible only if incurred in connection with a trade, business, or other profit seeking activity, carried on in a businesslike manner, with a real expectation of profits. That means that Ken Uston and other professional card counters with a history of winning substantiated by good business records should be able to take their travel expense to Atlantic City off their taxes. The IRS, and some courts, do not see it that way.

In an important recent case a federal court of appeals ruled that a full time gambler, who gambled only for his own account, was not engaged in a "trade or business."

The gambler thus could not deduct his gambling losses in arriving at adjusted gross income on his income tax return.

A few months earlier the United States Tax Court had ruled that a full time gambler, who gambled only for his own account, *was* in the "trade or business" of gambling. The gambler thus could deduct his gambling losses in arriving at adjusted gross income.

The two cases were obviously in direct conflict. The problem for the full time gambler now is to figure out what the law means for him. Unfortunately, the answer will probably depend more on where the gambler lives than on what the gambler does.

Different courts have applied different tests in trying to define exactly what is, and what is not, a "trade or business." Only the United States Supreme Court and the United States Congress have the power to make a definition that is binding on all courts. Yet, although the controversy has been brewing for decades, neither the Supreme Court nor Congress will face up to the problem.

Section 62 of the Internal Revenue Code allows a taxpayer to deduct all expenses "which are attributable to a trade or business carried on by the taxpayer" from his gross income. These include all expenses paid during the tax year which are "ordinary and necessary expenses," as defined in Section 162. For the full-time gambler the major question is whether his occupation is such a trade or business. If it is, the minor question is what expenses can he deduct.

To start with the easy question first, ordinary and necessary expenses for the business of gambling should include all gambling loses, transportation costs to the casino or track, hotel rooms and restaurants during the days that you are gambling full-time. The trip must be primarily for business, not for personal affairs. If you spend time playing golf, seeing the shows, or on other personal pleasures outside of your business of gambling, you risk losing this deduction; however, you are probably safe to do anything else on a trip if you spend at least eight hours a day in the casino.

Travel outside of the United States is subject to stricter controls, any time spent on personal affairs may reduce the amount you can deduct for business expenses. Expenses for your wife, who does not gamble, will not be deductible.

Other business deductions for the professional gambler include business periodicals and instruction courses. Information that helps you at your business of betting, such as subscriptions to gambling periodicals like *Gambling Times*, or the cost of this book, can be proven with a proof of purchase receipt, cancelled check or credit card statement.

Bribes or pay-offs to a dealer or athlete cannot be deducted because of the public policy against these criminal acts. However, not everything that is illegal is given such harsh treatment, business expenses connected with betting illegally should still be deductible.

Tips to dealers should be deductible like all other tips. When you place a bet for

a dealer you can take the bet as a deductible loss if the bet loses. If the bet you place for the dealer does win you are suppose to report the winnings and then deduct the entire amount given as a business related expense.

Even if you are not claiming tips as a business expense you should still be able to deduct them as gambling losses (when they lose) because they are not legally the dealers' until you win and hand them over.

It is possible for these expenses to be greater than the gambler's winnings, which would mean the gambler would pay no taxes. In fact, a "lucky" gambler who is held to be in the trade or business of gambling could carry over his tax losses from the losing year to reduce his taxes in the years that he wins big. On the other hand, the gambler might have to pay self-employment taxes for his business of gambling.

There is a presumption that an activity that makes a profit in two out of five years is carried on for profit. If you do not report at least some profit in at least two years out of five you are going to have a very hard time proving you are in the business of gambling. Showing a profit for at least two years gives you a big boost in proving your case, although the IRS is free to challenge you.

To report your income and deduct your expenses for your trade or business of gambling you will need to file a Schedule C "Profit or (Loss) From Business or Profession (Sole Proprietorship)" to your Form 1040 tax return. The profit or loss from this business will then be reported on line 12 of the Form 1040 and added to or subtracted from your other income.

Being in the trade or business of gambling can make a big difference in your taxes. An ordinary gambler reports his winnings as other income (Form 1040, line 22) and takes off only gambling losses, only if he itemizes, and only up to the amount won (Schedule A, Form 1040, line 22). The businessman gambler reports his winnings as income on a Schedule C and deducts not only his losses, but his other related expenses as well on the same form, before arriving at a figure to report as net income (Form 1040, line 12). And the businessman gambler can report a net loss for the year.

How can a full-time gambler find out whether he is in the trade or business of gambling for tax purposes? The cases lay out two main tests, each in direct conflict with the other.

The recent federal appellate court decision, entitled *Gajewski v. Commissioner of Internal Revenue*, 723 F.2d 1062 (2nd Cir. 1983), held that a gambler must hold himself out to others as offering goods or services, such as operating a bookmaking service or placing bets for others, to be in the trade or business of gambling. Betting on your own account, even if you do it full-time, even if you have no other income, even if you win consistently over the years, is simply not enough.

The federal appellate court distinguished previous cases that had held a speculator in stocks, trading only for his own account and not acting as a stock broker, was

in a trade or business. In a bit of creative legal fiction the court said, "Although the occupation of professional investor who invests for his own account may be similar in some respects to that of a professional gambler, the former does offer goods to others in the sense that he buys and sells securities." 723 F.2d at 1067 fn.8.

Nonsense, of course, since the stock speculator by definition is only interested in short term profits and not in holding himself out as supplying shares of stock to others.

The recent tax court case, entitled *Dittuno v. Commissioner of Internal Revenue*, 80 U.S.T.C. 362 (1983), held that the test was more flexible. The tax court specifically rejected the "holding out" test used by the other court as being too restrictive. The tax court went on to say, "To determine whether the activities of a taxpayer are 'carrying on a business' requires an examination of all the facts in each case." *Anthony J. Ditunno* Paragraph 80.12 P-H TC, 80 U.S.T.C. at 368 (1983).

The taxpayer in this case, Anthony J. Ditunno, was a full-time gambler with no other profession, employment, or income. He went to the race track 6 days a week, year round. In 1977, '78 and '79 Ditunno reported gambling winnings of approximately $60,000 per year and deducted gambling losses almost equal to his winnings as a business expense. The tax court held that he was in the trade or business of being a gambler and therefore the deductions were allowed.

A similar problem arises with the Keogh self-employment retirement plans. The IRS has ruled that only income from a legal business or trade can be sheltered through these plans. A professional poker player in Las Vegas, Billy Baxter, is fighting the IRS in federal court in Nevada, asserting that his profession should be considered a business or trade for tax purposes.

Even if you are held not to be in the trade or business of gambling you are not without hope. Section 165 of the Internal Revenue Code still allows all gamblers to deduct gambling losses off their taxes up the amount of that year's winnings. But the gambler must file an itemized return and no provision is made for deducting "ordinary and necessary" gambling expenses. The Code has another provision, Section 212, which allows as a deduction "all the ordinary and necessary expenses" paid during the year "for the production or collection of income," and at least one taxpayer was able to deduct the cost of a trip to Ireland to collect winnings on the Irish Sweepstakes. But you have to have a reasonable expectation of producing income; wishful thinking is not enough. The IRS has argued successfully in court that gamblers do not have reasonable expectations of producing income, particularly when the gambler claims more losses than winnings each year.

How will the courts rule in your case? The federal court opinion was from an influential tribunal, the Second Circuit Court of Appeals, but is binding only on gamblers in the states of New York, Vermont and Connecticut. Although other courts often look to the Second Circuit for guidance, they are free to apply either test when faced with the question of whether a gambler is in a trade or business.

My guess is that most courts will adopt the Second Circuit's "holding out" test, and the gambler who does not hold himself out as providing goods and services to others will be held not to be in a trade or business. Unfair as it may be, if you gamble on stocks, bonds and commodities you are an "investor;" make the same bets on horses or cards, even after years of research and practice, and you are a common gambler, not entitled to the tax advantages available to other businesses.

Another possible route for taking gambling expenses off your taxes is to try and come in under the tax Code's "hobby-loss" provisions. If you succeed you could take expenses off your taxes up to the amount of your winnings; with the "trade or business" provisions your expenses can exceed your winnings. Expenses under the hobby-loss would be limited, but would decrease your tax burden, possibly down to zero.

The hobby-loss provisions were first enacted in 1969 to prevent both imposition of a tax on personal activities that produce income but incur a greater amount of expenses and also to frustrate the use of pseudo-business losses in reducing income from other sources. The gambler has to show that the expenses were incurred in his betting activity, that they were conducted in a businesslike manner, and that the hobby involves the gambler's time and expertise.

You should again show a profit in at least two out of five consecutive years to get the presumption that you are gambling for profit. The IRS can challenge you but the court should look at whether you have a good faith reasonable expectation of making a profit.

There have been no definitive court decisions on taking gambling related expenses off your taxes. Most gamblers would not qualify under any tests the courts have used. However, professional handicappers and card counters should be able to make a good faith claim that they have a trade or business, or at least a hobby, if they keep records and conduct their gambling in a truly businesslike manner.

If you think you qualify, and enough of your tax money is at stake to make it worth while, you should contact a tax lawyer or certified public accountant and ask them if you can make a good faith claim. With a good faith claim you can take your expenses off your taxes now; you do not have to prove your case to the IRS or the courts until you are challenged.

11

Gambling Debts and the Law

Are Gambling Debts Collectible? First, a quick definition of a debt: a debt is merely one person's obligation to pay money to another, based on a prior agreement between the two. In other words, a form of contract. The question really should be, are gambling contracts enforceable?

Does it make any difference whether gambling contracts in general or specifically gambling debts are enforceable? Bookies usually operate by phone and money won or lost on races and sports events are not collected until the following week. It goes without saying that illegal gambling operations are going to have trouble collecting their debts, at least through the court system. It is a general rule of contract law that an agreement to do something that is illegal, like bet with a bookie, is unenforceable by either side to the transaction. Illegal gambling, and its vicious stepchild, loan-sharking, falls outside the protections of the courts.

Despite the cop shows on TV, the use of violence to collect debts is rarely used; but the threat is always present. It is probably very little comfort to know that the debt is uncollectible under the law. Of greater concern to the average bettor is the propensity of bookies to disappear, or refuse to pay, when the bettor wins big. Again the player is out of luck; the courts won't hear your case against the bookie, even if you can find him.

But what about legal gambling? The latest available statistics show that the ten casinos in Atlantic City issued $1,470,950,000 in "counter checks," or credit markers, to players in the first nine months of 1984. If credit play continued at this rate for the last three months of the year, and there is no reason to believe it would drop, in just this one year in this one form of legal gambling players will borrow $2 billion from the casinos. This does not include personal checks written directly to the casinos or to others, or credit cards or other forms of credit used to get cash to play.

A counter check is issued by the casino to keep track of chips given to players on credit. The player signs the counter check, which looks like a bank check, and receives playing chips in the amount of the check. If the player has enough chips at the end of his game he can redeem the counter check. If the player losses, or doesn't want to cancel the loan, the counter check will be deposited in the casino's bank for collection from the player's bank, just like any other check.

Why would anyone with enough chips not redeem a counter check? The player has received a short term, interest free loan, often for several thousand dollars. The loan is open-ended, the money is the player's until the casino can collect. This practice may be illegal, as a fraud on the casino. The casino regulators fear that casino insiders use this as a form of skimming; $10,000 markers have been issued to individuals whose home addresses turn out to be vacant lots.

Of the $1.47 billion issued in counter checks, from January through September, 1984, $1.18 billion was redeemed prior to deposit. The casinos thus acted as lenders for short term loans of over a billion dollars for the duration of the players' visit. Most players were able to pay off most of their loans by the end of their trips and the counter checks were cancelled as paid in full.

For some players, however, luck was not as kind. When a player cannot pay, or chooses not to, the casino has to try to collect. Over $288 million in counter checks remained unpaid after the players had left the casinos. Most of this money was recovered through the normal procedure of depositing the counter checks for collection: the casinos collected $249,829,000 from the players' banks in this way.

As for the rest, $36,282,000 in counter checks bounced in just those nine months. Adding this to prior unpaid counter checks, as of September 30, 1984, the ten casinos had a total of $71,887,000 in outstanding bum loans to players.

The casinos expect to collect most of this money eventually. They have made provisions for uncollectible checks of less than one percent of the total amount of counter checks issued. However, that one percent of loans written off by the casinos comes to $13,528,000.

If legal gambling debts are not collectible in court, and that is the law of many states, the casinos stand to lose tens of millions of dollars. And the casinos are not the only form of legal gambling, nor are they the only people who lend money to gamblers.

Anyone who lends anybody money, knowing the money will be used for gambling, is making a gambling contract that is probably unenforceable. If you get a loan from a friend, a bank or even a credit card and the lender knows you are going to use the money to gamble the lender cannot use the courts to collect, should you decide not to repay the loan.

Since debts are merely one form of contract, if gambling debts are not collectible other forms of contracts are also unenforceable. If two people go in on a lottery ticket

they have made a contract to split the winnings. If only one of their names is on the ticket and he refuses to share the winnings can the other person sue for half? Most states now will enforce an agreement to split winnings, if the lottery is legal. There is some dispute in the law whether the agreement will be enforced if the lottery is legal but the agreement is made and the ticket is bought in a state where the selling of lottery tickets is illegal.

If the lottery is illegal the courts will not aid the parties at all. A gas station in Georgia gave customers a ticket for a drawing with each purchase. The winning ticket would receive an automobile. One of the gas station's better customers, Bartow Dennis, was able to accumulate a number of such tickets. Dennis' girl friend, Elizabeth Weaver, claimed he had given the tickets to her. She also claimed that when one of the tickets turned out to be the winning one, Dennis snuck into her pocketbook, stole the ticket back, and claimed the prize. She sued.

The Court of Appeals of Georgia said the gas station's scheme was an illegal gift enterprise or lottery and "the courts will not lend their aid in determining the title to a ticket issued in such a scheme or enterprise, or the rights of an alleged holder thereof to the prize, or the value thereof." *Dennis v. Weaver*, 121 S.E.2d 190, 191 (Ga.Ct.App. 1961). Which means Dennis keeps the car but loses the girl.

Although there have not been a lot of reported cases, there is a growing body of law involving the new state lotteries. As a form of gambling the state lottery is subject to all of the restrictions and controls the law imposes in all legal gambling. Courts have held, for example, that a lottery winner cannot collect without the ticket, even when there is no dispute that the ticket was lost or stolen. A winner who fails to claim his prize in time is out of luck. Even when it is only the lottery that makes the mistake, such as in printing too many winning tickets, the lottery does not have to pay.

Although there are no cases on the point, it is conceivable that a jurisdiction that says gambling contracts are not enforceable could use that law to invalidate construction contracts to build a casino or contracts to buy, sell or ship otherwise legal slot machines. That is not as inconceivable as it sounds; the Supreme Court of Nevada has consistently held that gambling is against the public policy of Nevada and gambling contracts are not enforceable through the courts of that state.

Up until a few years ago the question of whether gambling debts are collectible could be answered quite simply: No, gambling debts were not collectible in the eyes of the law. An agreement that involved gambling would not be enforced in a court of law.

Of course, nothing in the law is ever simple, and a good lawyer can almost always find an exception to even the strictest rule. Still, the law on gambling debts had been fairly well settled since 1710 when Queen Anne of England signed the Statute of Anne.

As I showed in Chapter Six, this ancient English statute is of great importance

to gamblers in modern America because the Statute of Anne is part of the common law of every state. It clearly is still the law of Nevada, except for those parts that have been explicitly changed by the Nevada Legislature or thrown out as not applicable to modern America by the state Supreme Court.

The Statute of Anne was designed to attack gambling and protect wealthy landowners by prohibiting winners from using the courts to collect gambling debts. Securities and notes given in payment of a gambling loss and IOUs became worthless; this benefited the landed gentry who had to gamble on credit. The Statute was broad in its scope and in its effect on the law; it made all gambling contracts unenforceable in all common law jurisdictions, meaning in every court in every part of the United States.

Many lawmakers in Puritan times wanted to go on record as being against gambling and to make it clear that this law still applied. Although it was probably unnecessary, Colonial and early state legislatures passed laws encompassing the anti-gambling provisions of the Statute of Anne, including making gambling debts uncollectible and allowing losers, or anyone else, to sue the winners and get triple the money back. (Some states, for example, Virginia and Massachusetts, still have laws on their books allowing losers, or even non-players, to sue winners, to get back money lost at illegal gambling. Each of these states averages one case every hundred years or so on these bizarre laws.)

Unless the state legislature has explicitly changed the law, gambling debts, in fact all contracts having anything to do with gambling, are unenforceable in a court of law. The court will not even look at the merits of the case; as soon as it realizes that a gambling debt or contract is involved it will dismiss the case.

With a contract that is illegal, such as an agreement to provide sexual service for pay (prostitution) or to sell illegal drugs, the courts will "leave the parties where it finds them" and will automatically dismiss every claim. The Statute of Anne requires the courts to treat gambling debts the same way, even if the gambling is legal.

Thus the law of gambling debts stood for almost three centuries: illegal bets, from a debt owed to a bookie to a check written at a friendly poker game, are void and unenforceable. But so were legal bets under the Statute of Anne. If a player stopped payment on a check to a Nevada casino the casino could not use the court system to collect.

And since debts can run both ways, players who thought they were owed money by a casino were consistently thrown out of court. Gambling debts were simply not collectible, whether the claim was based on a player's marker or a winning bet at a licensed casino.

Take the case of Kenneth W. Corbin. Corbin thought he had a sure thing. Back in March, 1967, when the Boston Red Sox were down in the cellar, Corbin bet $100 with the Jockey Turf Club of Washoe County, Nevada, that his team would win the

American League pennant. And despite tremendous odds, 200 to 1 to be exact, the Red Sox pulled it off. Corbin had won a dream bet: $20,000 from a licensed gambling establishment in a state where gambling was legal. Now all he had to do was pick up his money.

He couldn't collect.

The Club refused to pay, claiming the bet had been taken by an employee who had pocketed the cash and had never recorded the wager. That certainly was not Corbin's fault, but the Club was sorry, it would not pay.

Corbin took his claim to the Nevada Gaming Control Board, but the Board turned him down. So Corbin went to court.

Specifically, he went to the Second Judicial District Court of Washoe County, a state trial court. The trial court threw him out. He appealed that decision to the highest court in the land, the Supreme Court of Nevada. The Supreme Court did what every court in every state in the United States would do in such a case: they threw him out of court.

Kenneth W. Corbin ran into the great anachronism of 20th century American gambling law: gambling debts are uncollectible, at least most of the time. From the smallest of small time welchers who owes a few bucks to his neighborhood bookie to, as Corbin found out, a legal $20,000 win from a licensed casino, a winner cannot use the court system to collect one cent under the Statute of Anne, which is the law of Nevada today.

It is up to the courts and legislatures of each individual state to decide to what extent the Statute of Anne should be modified. In Nevada, the state Supreme Court has repeatedly and clearly stated the public policy of that state: money owed for legal gambling debts is like money owed to a prostitute or to pay for illegal drugs; the courts will not dirty their hands with cases involving gambling.

Despite the evidence all around them of Nevada's dependence on legal gambling, and the state Legislature's declaration that "The gaming industry is vitally important to the economy of the state and the general welfare of the inhabitants," NRS Section 463.130(1), the Nevada Supreme Court has consistently ruled that gambling is against the public policy of the state. As the justices told Kenneth Corbin, "This court has refused to aid in the collection of gambling debts for nearly a century and we will not depart from those cases." *Corbin v. O'Keefe*, 87 Nev. 189, 484 P.2d 566, 567 (1971).

But just because the casinos cannot collect through the court system does not mean they cannot collect through the banking system, if nobody objects. This is the reason markers are made out like checks; the casinos try to push the IOUs through the bettor's bank as fast as possible when the gambler acts in a suspicious manner.

If the bettor can stop payment on his check or has insufficient funds, the casino used to be out of luck.

The Nevada casinos were actually not as unhappy as you might imagine about this situation. Most players' checks and markers were good, they could be cashed immediately. The great majority of those checks that bounced were also eventually made good, without the casino having to resort to the court system. A few phone calls and threats, not necessarily threats of physical violence but threats to cut off the player from gambling, normally resulted in a settlement, often in the form of a promissory note with payments spread out over time. The promissory note was no more enforceable than the original checks, but could be turned into court judgment quickly, and most people tend to pay off legal-looking documents.

The main reason the Nevada casinos did not care about the enforceability of their markers was that they actually received a tax benefit from the Statute of Anne. A business that is on the accrual basis, as are most large companies, have to report as income money owed by its customers. The business can put aside some small percentage for bad debts, but it normally has to pay taxes on its accounts receivable, even before it sees a penny in cash. However, if the accounts receivable are not enforceable in a court of law they do not have to be reported as income. Casinos could, and did, have millions of dollars in markers outstanding, but did not have to report any of these IOUs as income, and did not have to pay income taxes on any of them, until the money was actually received.

When many Nevada casinos had ties to the underworld and debt collection practices were cruder the casinos did not care much that they were barred from the court system. Even legitimate operators in the 1940s and 1950s were legally allowed to use strong arm tactics that are forbidden today. After the early casino operators sold out to publicly traded corporations and legal gambling became a legitimate corporate business, the MBAs and CPAs could live with the Statute of Anne. Corporate casino management was collecting most of their debts anyway, and the whole system gave them tax advantages. However, when Atlantic City opened and competition for the first time started to eat into the Nevada casino profits, the casinos finally began to worry about their uncollectible gambling debts.

The final blow came in 1980 when a federal court in Nevada ruled that an "accrual-basis" casino had to include in its taxable income all receivables created by the extension of credit to gamblers. The federal Court of Appeals affirmed the decision—casinos now had to pay taxes on markers, whether or not those markers were legally collectible under Nevada law. After some debate among the casinos, it was decided to press the Nevada Legislature to change the law of gambling debts.

It was only within the last two years that the Nevada legislature repealed that part of the Statute of Anne that made gambling debts uncollectible.

In 1983 the Nevada state legislature amended the Nevada Gaming Control Act in two significant ways. Senate Bill No. 335 gave casinos the power to accept written

"credit instruments" from players and, for the first time, to enforce those gambling debts in court.

Players were not completely left out, but were certainly not given equal treatment. Assembly Bill No. 536, also passed in 1983, requires gambling houses to immediately notify the State Gaming Control Board whenever they refuse to pay an alleged winner. The Board appoints an agent to conduct an investigation. The "aggrieved party" has the right to file a petition with the Board and request a hearing to protest the agent's decision. After the hearing the Board issues a decision in writing. Only then can the player obtain limited review by the courts, and then only at his own expense.

The new law does not really add anything, for the players always had the right to go to the Board with their case. If the Board decided that the player should be paid, of course the casino would pay. As the Nevada Supreme Court told Jack Weisbrod, who claimed to hold a $12,500 winning keno ticket that the Fremont Hotel refused to honor, "No licensee is likely to place his license in jeopardy through refusal to pay a gambling debt found to be properly due." *Weisbrod v. Fremont Hotel, Inc.*, 74 Nev. 227, 326 P.2d 1104, 1105 (1958).

Assembly Bill No. 536 makes it clear that it is not changing the Statute of Anne, that what is good for the casino is not necessarily good for the players. The Bill starts off with the following statement: "Except as provided in sections 2 to 8, inclusive of this act [dealing with the Board's investigation and hearing], gaming debts not evidenced by a credit instrument are void and unenforceable and do not give rise to any administrative or civil cause of action."

The bottom line is that Nevada casinos can now sue any player who has signed a "credit instrument" and collect a gambling debt through the court system of Nevada. Players, on the other hand, have to be satisfied with administrative procedures by the Gaming Control Board; for them gambling debts are as uncollectible in the courts of modern day Nevada as they were in 18th century England.

It remains to be seen whether a law that is so unfair on its face will stand up in the courts. I suspect that the first time a player is sued under this new law and his lawyer challenges the law on the constitutional grounds of equal protection and due process, a judge will throw the Nevada statute out because it discriminates in favor of the casinos.

Nevada is not the only place you can gamble legally. Some legislatures have chosen to modify the Statute of Anne in other ways.

There always were a few exceptions to the general rule against collectibility of gambling debts. One way to get around the common law is to say the Statute of Anne does not apply. In some states the state legislatures have required the track operators to pay off winning horse racing tickets, bought at the track, since the tracks are given licenses by the state. In other states, the courts have held that the tracks must pay

off winners on the grounds that the tracks are not gambling with the players, only acting as stakeholders for the parimutuel bettors. Louisiana enforces bets and gambling contracts that promoted horse racing, shooting matches, and foot races, on the theory that these were not gambling but necessary "skills of war" vital to military preparedness.

Some foreign jurisdictions, such as the Bahamas, have made gambling contracts enforceable. And Puerto Rico, which is part of the United States, has made casino debts collectible, with a slight catch.

The laws of Puerto Rico make a gambler liable for his losses. But the gambler has an out. The law states that a judge "may either not admit the claim when the sum which was wagered in the game or bet is excessive, or may reduce the obligation to the amount it may exceed the customs of a good father of a family." Therefore, if a big loser can prove that his gambling debts are more than those of a "good father of a family" he should be able to get the excess kicked out. There has never been a reported case involving the use of this strange archaic law.

What about Atlantic City? The New Jersey legislature, when it legalized casinos in Atlantic City, set up a detailed system for the collection of casino debts. Under the New Jersey Casino Control Act, Section 101, markers and IOUs are not collectible; checks made out to the casino are collectible, but only if they are made out to the casino, dated and presented to the cashier for credit slips that are then exchanged at the table for playing chips.

In addition, the New Jersey Legislature allows a big loser time, up to a point, to come up with the cash to pay off the checks. The casino must deposit a check for collection within seven banking days if it is for under $1,000; within 14 banking days if under $2,500; and the big loser has up to 90 banking days before the casino must demand payment if the check is over $2,500. If the player can come up with the cash the casino must redeem the check, thus allowing a player to get an interest free short term loan while protecting his credit at his home bank.

In 1983 Playboy was able to defend its casino credit system and collect a $40,000 debt from a player through the New Jersey court system. I doubt whether a player could successfully challenge any Atlantic City casino's credit procedure in a New Jersey court.

English casinos have exactly the opposite law. A check written to a casino must go through the player's bank for collection, it cannot be redeemed even if the player wins enough on the spot before the check is deposited by the casino. The English lawmakers wanted the player's home bank to know about his gambling; they figured that a person would be shamed into stopping rather than have his local banker see three or four checks written in the same night to the same casino.

English law does not allow casinos to offer credit of any kind. Rich Arabs, who have no respect for the subtleties of English law, have destroyed many English casinos

by insisting on the right to play for credit. The casinos were faced with the choice between losing players who literally have money to burn or obeying the strict rules against granting credit. Those English casinos that gave in to the Arabs lost more than they gambled for: they ended up losing their licenses.

Even a casino that refused to grant direct credit to the rich Arabs could be punished for giving in to these oil millionaires' thoughtless unconcern for our banking laws. Victor Lownes, the man who launched Playboy's London casinos, reported in his book, *The Day The Bunny Died,* that the British regulators took away Playboy's London casino license in part for allowing these extraordinarily rich players to bend the rules when they were short of cash. Playboy was punished for accepting new checks from players whose previous checks had bounced, a practice the regulators viewed as granting credit.

Even in those jurisdictions that have left the Statute of Anne unchanged, only money loaned for gambling is uncollectible. If the casino can prove it cashed a check in the casino restaurant or hotel it can collect in any court wherever the player could be found. It has become quite a game: the casinos are caught between pressures for extending easy credit to gain high rollers and the fear of non-collectibility if the player can prove the credit was used for gambling purposes.

As another example of the strange, medieval nature of the law, many states treat gambling debts as debts of honor. Under the code of the Prussian officers, a gentleman who could not pay his gambling debts was required to commit suicide. Today a debt of honor may not lead to suicide, but often it can be collected, if certain conditions are met.

A loser making a separate and distinct promise to pay his debt in return for the winner's promise not to tell anyone of the debt may find himself facing a judge who believes in debts of honor. The moral is to keep your mouth shut and never promise to pay, especially not in writing. Of course, it is easier and smarter not to go into debt at all.

Since each state makes its own laws on gambling and gambling debts, confusion often reigns when a gambler loses money in one state and the casino tries to collect in another. Take the case of Merle C. Gibbs. Gibbs's friend, Art Nelson, had been invited on a free junket to Lake Tahoe, with free transportation by way of private plane, and all hotel bills, meals, and drinks to be picked up by Harvey's Wagon Wheel. Nelson invited Gibbs along as a guest. Gibbs's weekend began to turn sour as he started to lose, first at Harvey's and later at Harrah's Club, also in Tahoe. Gibbs started writing checks to get more chips; by the end of the weekend he had written five checks totaling $1,900. This may not seem like a fortune, but it was to Gibbs; the checks were returned due to insufficient funds. Gibbs lived in California so the casinos sued him there, where they could find him.

The California judge hearing the case knew that California had horse racing, high-

draw and low-ball draw poker clubs, and was in many respects as big a gambling state as Nevada. He said, "In these modern days Californians cannot afford to be too pious about this matter of gambling." *Lane & Pyron, Inc. v. Gibbs*, 71 Cal.Rptr. 817, 266 Cal.App. 61 (1968). Yet, the court threw the case out. Why? Because California is not about to enforce a gambling debt made in Nevada if Nevada courts would not enforce it themselves.

That case used to be easy: since Nevada would not enforce a gambling debt, no other state would help a Nevada casino collect. But Nevada now has made gambling debts collectible, at least for the casino. And what about Puerto Rico or New Jersey casinos or any other gambling debt incurred in a locale that makes the debtor pay? Here the answer is not as clear.

States are supposed to enforce the laws of the other states—in legalese the concept is known as "comity." The idea is that if we respect a foreigner's laws they will respect ours. But the states have an out; they do not have to follow the laws of their fellow states if those foreign laws are against "public policy." It is hard to imagine how the law of one state can be against the public policy of another state, until you look at gambling laws.

Say you've just returned home from a whirlwind vacation to the Caribbean, where you've written checks with abandon in casinos. Unfortunately, you've lost almost consistently. Now you are having some sober second thoughts about those large checks that will be coming through, devastating your checking account. So you stop payment on the checks. What can the casinos do?

The answer is like a game of Monopoly; it all depends on whether you can pass "Go" and return home free. If the casinos catch you in New York or New Jersey, you're stuck for the entire amount. If you reach the safety of Connecticut, Florida or most other states, you are probably safe. Of course, you will be harassed for years by bill collectors, but, unless the states change their laws, you probably won't have to pay a penny.

How can a gambler know whether his state is a safe port for gambling debtors? You can ask a lawyer, but even he may not know, unless there is a statute on the books or a recent ruling by the state's highest court. And such a ruling is not likely. The leading ruling in Kentucky was decided over 135 years ago. It is not safe to rely on a case that old. The illegal gambling was horse racing, in a state that is now famous for horse racing. And the bet was not for cash; the winner said that he had won a "negro boy"—a slave. It is very possible a modern Kentucky court would overturn that decision, but it may not.

The situation is different if the casinos actually sue you in their home state. This can happen if you return to gamble and are served with a complaint while being physically present in their state. You need not even be physically present to be served. Almost all states now have what are known as "long arm statutes." If you have enough

contacts with that state to make it fair to drag you back for a lawsuit you can be served by mail. If you do not show up a default judgment will be entered against you. That judgment can now be taken to the state where you live. The courts of your home state have to enforce the default judgment, even if gambling is against the public policy of your home state. The U.S. Constitution requires that each state give "full faith and credit" to the court decisions of every other state.

Casinos have come under fire for their lax standards for giving credit. Certainly it is easier to get a large loan from a casino, say $100,000 in playing chips redeemable in cash, than it would be to get the same size loan from a bank or any place else.

But before you go building up a big debt in Las Vegas, with the intention of skipping out, there are a few practical points to consider. You still have to meet their credit requirements, loose as they may be. And casinos, like any other business, do not like people who do not pay their bills.

The blackball is alive and well in Nevada, a player can legally be excluded from playing in every club in the state. Of course, if you are foolish enough to return and be recognized you will be served with a complaint.

The casinos can turn the account over to legitimate collection agencies that may not break your arm, but can be awfully rough. They can also file suit; of course, it will probably lose, but the threat of bad publicity to a businessman with a reputation and credit rating to protect may be enough to force payment. There is always the chance the casino might be able to prove the checks cashed were not used for gambling purposes and are thus collectible.

If you are thinking of running up a big debt in a casino and then hiding in a state with a public policy against gambling, be advised that the trend of recent court decisions is against you. With the spread of lotteries and other signs of the third wave of legalized gambling throughout the United States, it is getting more and more difficult for a state to claim that all forms of gambling are opposed by public policy. Public policy is, after all, only a shorthand way of saying, "What the people of this state want." And the people everywhere more and more want legal gambling.

What does all this mean to the player? The experienced player knows that winning, or losing, is only half the game—the other half is collecting.

Although the law is constantly changing, or at least being challenged by developments in the real world, some points are clear. I believe the following is true of gambling law in America in the late 1980s:

Licensed casinos can collect from you, the player, if they catch you in their state. This means that Atlantic City casinos can give you credit and can collect on all unpaid markers, so long as they can find you in New Jersey. Similarly, Nevada casinos can now enforce written markers through the courts of Nevada, and Puerto Rican casinos can obtain judgments in the courts of that commonwealth.

The casinos sometimes have strict rules they must follow in the offering and col-

lection of gambling credit, but I am confident that every licensed casino has by now learned what it must do to make its written markers enforceable, or will soon be hiring new legal counsel.

Notice the limitations and qualifications of this right to collect by casinos: a licensed casino can collect on its written markers in its home state. This does not mean oral extensions of credit are enforceable. Nor does it mean that casinos can go to court outside of their home state. It is far from certain, for example, whether Nevada courts will enforce valid New Jersey casino debts.

So the home court player has a distinct disadvantage in his home court casinos (at least if he is trying to avoid paying his debts). What about out-of-staters?

It is impossible to tell whether a licensed casino can collect on an out-of-state player without going to a lawyer. I simply cannot tell you the laws of all fifty states and assorted commonwealths, territories and the District of Columbia, because each jurisdiction is free to make up its own mind about gambling debts. I also do not know to what extent the casinos will use their state's long arm statutes, or whether the courts will uphold their use for gambling debt cases.

In general the law is that gambling debts are not collectible, but the exceptions may hit you where you live. If you live in Virginia and stop payment on a check made out to an Atlantic City casino you do not have to worry, unless you fall within the provisions of New Jersey's long arm statute. Other than a few intimidating phone calls and the loss of your credit rating you will never have to pay a penny. The courts of Florida and Texas have similarly thrown out claims by licensed casinos. However, New York and New Jersey have allowed out-of-state casinos to use their courts and collect, if the gambling debt was enforceable where incurred.

The most interesting states to watch will be California and Nevada. California has never had to decide whether it would allow out-of-state casinos to use its courts because it relied on Nevada's law. Nevada courts, prior to the recent legislative enactment, had consistently held gambling debts were not enforceable. Can a California resident now stop payment on a check written to a Nevada casino and escape scot-free? Will the Nevada courts reverse 112 years of case law and enforce gambling debts incurred in New Jersey?

My advice would be to pay your debts, or better yet, don't ever sign a marker in a casino.

If you win in a licensed casino you will be paid, but you will have to use administrative rather than court proceedings to collect. When the casino loses the law is clear: their gambling debt to you is unenforceable. However, no casino wants to put its license in jeopardy if the bet should be paid off. Nevada now has a detailed scheme to give the player a chance to tell the state authorities his side of the story. However, if the casino goes bankrupt, or you would rather sue in the courts of your home state, or even in the courts of the casino's state, you are simply out of luck.

Illegal and social gambling debts are still unenforceable. Certainly they are *collectible*, through threats of violence, and it is probably little consolation to know that the bookie or loan shark cannot use a court of law to collect. But this information may be of use to the social gambler.

Checks written at the end of all-night poker games are no more legally enforceable than a contract for prostitution. But like prostitution, once the terms of the contract have been fulfilled the courts do not have the power to undo the deed. For the gambler this means that your checks are no good, unless they have already been cashed.

If you won last night in the big poker game be at the bank first thing the next morning; if you lost, hope that your check bounces for insufficient funds. (It is a crime to write a check knowing that you do not have funds to cover it.) Remember, the courts will leave the parties exactly as it finds them.

Like all of the information given in this book, these are simply guidelines. If your money or freedom is at stake consult a lawyer. Gambling law is filled with loopholes. Take the case of Leonard H. Wolff.

Leonard H. Wolff found the only sure thing in gambling. On October 23, 1948, while playing blackjack, Wolff wrote three checks to a casino in Nevada for $7,000, $29,000, and $50,000. Although the casino tried to collect from Wolff's bank the next day and Wolff had the money to pay, the Nevada Supreme Court would not let the bank honor the checks. And Wolff could not care less about losing his credit rating or being blackballed from the clubs in Nevada. For Wolff had died that same night; proving that only in gambling, you can take it with you.

12

Collecting Gambling Debts Across State Lines

When dealing with the law of gambling debts it pays to divide the cases into two parts: lawsuits brought in the state where the bet was made and lawsuits brought in a different state.

In general the first set of cases is easy, because only one set of laws apply. It is still necessary to determine what that law is, but usually all that is required is to look up the state statutes on gambling debts and any cases that may have interpreted the common law. If you did so you would find that every state (I believe) prohibits the use of the courts for the collecting of illegal bets. The illegal bookie is barred from suing the losing player; of course, he has other ways of collecting. The winning player is equally barred from suing the bookie.

A *losing* player may be able to get back his money under those statutes, dating back to the Statute of Anne, that are designed to discourage gambling. Sometimes those statutes require that the loser be a casual player and the winner be a commercial, illegal operator. Similar statutes may allow a loser to sue if he has been cheated, even if the game is illegal. But these are not really gambling debt cases; the player has paid off and is now trying to get his money back.

Since the law of illegal gambling debts is clear I will limit this discussion to games that are legal.

When a winner sues to collect in a state where the game is legal, the question becomes whether the Statute of Anne is still in force. In Nevada, Puerto Rico and New Jersey a casino can sue a player and collect. In Nevada the player cannot sue the casino. In other states a winner at the track can probably sue the track, a lottery winner can probably sue the lottery; and vice versa. On the other hand, licensed card rooms, bingo halls and the other forms of legal gambling are more likely than not out of luck; neither the player nor the house can use the courts to settle a dispute.

This first set of cases, suing in a state where the game is legal, usually involve

the citizen of that state suing another citizen of the same state. Typical cases include a Las Vegas casino trying to collect against a Nevada resident, a New York bingo winner suing a New York charity, or one Californian suing another who stopped payment on a check for a loan for a stake at a licensed poker club. Less common are cases involving nonresident defendants. The law here is changing and a person who does not live in the state where the game is legal may find himself being haled back to face an unfriendly set of laws.

If you lost big in Nevada or Puerto Rico, it used to be safe to run home and stop payment on the checks. Safe and sound in Chicago the losing player could kick himself for losing so much, change his phone number to avoid harassing calls, and make it a point never to return to Nevada or Puerto Rico so that he could not be sued.

The law used to require the loser to come back, to be physically present in the state, to be served with a summons and complaint. If the player did make the mistake of returning to the resort he would be served with the papers. Once served, it did no good to run; the lawsuit would continue with or without the defendant. After being served if he left the state a default judgment would be entered against him, which the casino could collect anywhere it found the player. But without service there would be no lawsuit at all.

This law is undergoing change. Most states have now instituted what are known as "long arm statutes," to serve nonresidents who refuse to return. Each state is free to decide the reach of its long arm statute. Most have chosen to go to the limits, to protect the rights of its own citizens. The people wanting long arm statutes are local businesses and individuals who want to bring back nonresidents who have done them wrong. The U.S. Supreme Court has upheld these long arm statutes and out of state service, so long as the person being sued has had enough contact with the gambling state to make it fair to drag him back.

Using a long arm statute the winner of a legal game could send the summons and complaint through the mail to the loser who refuses to pay. Say you have stopped payment on a check cashed in a legal casino and have received the papers in the mail. You now have two options, neither one of them happy. You can show up and defend against the suit on the grounds that the debt is no good for some reason or that you do not have enough contacts with the casino state to make it fair to use the long arm statute against you. Or, you can not show up and have a default judgment taken against you. When the winner comes to your home state to collect the default judgment you can then try and fight.

Both options have their drawbacks. Returning to the winner's state is going to be a costly ordeal, even if you eventually win. If you lose there on the fight over the long arm statute you will have to fight the case on the merits all the way, in front of an unfriendly judge. On the other hand, if you default you can no longer fight the case on its merits, such as claiming there was a defect in the marker, or that

you were cheated. When the winner comes to your home state your home courts are required to give full faith and credit under the U.S. Constitution and enforce that judgment just as if it were one of their own. Your only argument can be that the judgment is no good because the use of their long arm statute was wrong. Your home court will be sympathetic and you may win on this point, but if you lose you will have to pay the entire default judgment.

Casinos and other legal games have not caught on to the use of long arm statutes to any great extent. Instead of suing in their own, friendly home courts, they travel to the loser's home state and sue him there. That is a strategic mistake that can work to the great benefit of the losing player.

Say you are served at home in Los Angeles with a summons and complaint from a Las Vegas casino for nonpayment of casino markers. The casino has chosen to file in your home state court, the Superior Court of California. You now can defend the case on the merits, without having to travel out of state, and with an additional weapon. The California Court will not only have to decide the facts and the law of Nevada, it will have to determine whether the laws of California will allow collection of such a debt. Casino gambling, after all, is not legal in California.

If the bet had been made in California it would have been illegal and not enforceable. You will argue that the bet may have been valid where made but it is absolutely void under the laws of this state and the casino should not be allowed to use the courts to collect an unenforceable contract.

The casino will argue that it is a fundamental principle of American law that the courts of one state will enforce the laws of another state, a principle known as "comity." The casino is correct, comity requires respect for a sister state's laws, but only so long as the foreign laws are not contrary to public policy. And there's the rub. Is casino gambling against the public policy of California?

The legal issues involved require the answers to two separate questions. First, California, the forum state, must decide the choice of law to use: should the California court apply California law or Nevada law? Second, even if the court decides to apply Nevada law, will it still say that Nevada law is so repugnant to the public policy of California that the courts of California will refuse to follow that law?

The courts are divided on the answers to these questions. The majority of cases have held that a local law making gambling contracts unenforceable precludes the foreign casino from using the local courts. Courts have held that there is strong evidence of a local public policy against all gambling debts, where the state legislature has passed a statute. Courts have used evidence of local opposition to gambling to kick legal foreign gamblers out of court, even when the local law states on its face that it only applies to local bets.

Other courts have held the opposite. Sometimes the courts state that there is no local public policy about out-of-state gambling, or the public policy is not strong

enough to override the need to respect the laws of sister states. The current trend, by no means universally accepted, is to find that local public policy does not oppose legal gambling, as evidenced by the local legalizations of lotteries, bingo and other parts of the third wave.

The particular facts may make a difference in the outcome. The courts are unsympathetic toward a winner who refuses to share his gambling winnings with another person who put up some of the stake. As far back as 1846 a court in Kentucky made the distinction between enforcing gambling bets between a winner and a loser and the splitting of gambling winnings. Kentucky law at the time prohibited betting on horse racing and the courts of that state refused to enforce a gambling contract on a horse race, even those validly made in another state. The state's highest court held this principle did not apply where two people legally made a joint bet in Mississippi on a legal Louisiana horse race, and the individual who received the winnings refused to share them. The Court held no public policy was violated by allowing the co-winner to sue.

Similarly, Michigan has allowed a co-winner to sue to split winnings of an Irish Sweepstakes ticket, even though those tickets are illegal in Michigan. And Texas allowed enforcement of an agreement to share winnings of the legal Mexican National Lottery since the winner who refused to share was taking property that rightfully belonged to his partner. The Texas court held that Texas has a strong public policy against such wrongful takings of property. The court stressed that the results might have been different if the rights of a third party were involved.

We are dealing with an area that is left up to the individual states to decide. This may seem strange since we are talking about a conflict between the laws of two states, an issue that would seem to call for the federal government to resolve. Just the opposite is true. Gambling laws and a state's public policy are uniquely areas of state law; the federal government has no role here at all, so long as the parties and states stay within the broad limits of the U.S. Constitution.

If you are sued in California by a Nevada casino you can fight the case all the way up to the California Supreme Court. The California state courts will have to interpret California state law and Nevada state law. If the California Supreme Court makes a mistake there is no appeal to the U.S. Supreme Court. The U.S. Supreme Court cannot override a state court on an issue of state law; the highest Court is limited to issues of federal law and the U.S. Constitution.

Occasionally a state law issue will end up in federal trial court. In gambling debt cases this is rare, but it has happened, particularly when the plaintiff and defendant are from different states or foreign countries and the plaintiff chooses, for some reason, to sue in federal rather than state court. The federal court now has to act like a state court and decide what a state court would do under this set of facts. One reason there are not too many of these cases is that the federal courts do not like having to second