
Coates' Canons Blog: What's Next for Video Sweepstakes?

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It took more than two years, but the ban on video sweepstakes that was originally scheduled to take effect in December 2010 is finally enforceable. The North Carolina Supreme Court ruled on December 14, 2012, that the ban did not violate the sweepstakes operators' free speech rights under the First Amendment. Appellate court rulings become effective after 20 days, meaning that just after New Years' Day local law enforcement could begin enforcing the ban and shutting down video sweepstakes parlors.

So the long and winding saga finally ends, right? Video sweepstakes machines disappear from the state, never to return again, along with the jobs they created and the risk of Grandma blowing her grocery money playing pseudo slot machines.

Not so fast. Plenty of video sweepstakes operators closed their doors after the ruling. But not all of them. And some that have closed may reopen after changes to their operating systems, more legislation, or additional court rulings.

Because the case involves a federal constitutional claim, the video sweepstakes operators can ask for a review before United States Supreme Court. The odds are against them, however. Our nation's highest court agrees to hear fewer than 2% of all cases seeking review.

A successful appeal might not be necessary for the video operators to remain in business. Even before the state supreme court issued its ruling, lawyers for some of the companies providing video sweepstakes technology informed local governments that if the ban were upheld they planned to tweak their systems so as to conform with the newly enforceable law.

As my colleague Jeff Welty explains here, the ban does not prohibit all video/computer/internet sweepstakes, only those that use electronic machines to reveal the result of a sweepstakes entry via an "entertaining display . . . that takes the form of actual game play or simulated game play." G.S. 14-306.4. Presumably the video sweepstakes operators could still use computers to inform their customers whether their "free" sweepstakes entries are winners—so long as those computers used some method that was not a game or a simulated game.

One approach that might avoid the ban is a plain-vanilla reveal. The sweepstakes computers could ask the customers how many entries they wish to reveal, then simply state how much money those entries did nor did not win. Sounds pretty boring to me, but who knows? Maybe some customers would still enjoy the process enough to continue losing their money on the sweepstakes.

More entertaining approaches might also skirt the ban. For example, the computer could show a digital dart flying toward a wall of digital balloons. When the dart "hits" a digital balloon, the balloon pops and reveals whether or not the customer wins any money. Is this method of revealing the result of an entry "actual game play or simulated game play"? If the customer cannot control where the dart flies or which balloon it hits, it sounds more like a film clip than a game to me. But others might disagree.

The N.C. Attorney General's office has declined to offer an advisory opinion as to what types of video sweepstakes, if any, can continue to operate under the ban. Which means it's going to be up to local law enforcement to decide when and how to enforce the ban. We won't know for sure what activities remain legal until an operator is cited for violating the ban and a court is forced to address the issue of just what constitutes a "game" in the context of video sweepstakes. And then we'd certainly be in for another year or two of appeals before the N.C. Supreme Court had the final say.

Then again, the state legislature could reword the ban to eliminate the reference to games and then (potentially) prohibit all types of video sweepstakes. Or, as former governor Bev Perdue proposed last year, the General Assembly could

legalize video sweepstakes and heavily tax the industry. It wouldn't be a huge leap to imagine a state-sanctioned video sweepstakes industry, considering that we already have a state-sanctioned lottery.

Recent comments from newly inaugurated Governor Pat McCrory suggest that he prefers strengthening the ban rather than legalizing the sweepstakes. "I think they ought to enforce the law," McCrory said, "There seems to be so many loopholes the industry is looking for to go around the current laws...This is kind of ridiculous at this point in time."

It's clear from feedback I've been receiving that not every local government wants video sweepstakes businesses to disappear. A number of cities and towns are generating substantial revenue through privilege license taxes on these businesses and have not experienced increased crime or other problems with their local sweepstakes parlors. Roanoke Rapids, for example, hopes to rely on video sweepstakes machines to rescue its financially troubled and publicly funded theater. That city's attorney has already reviewed the "new" version of the video sweepstakes systems and pronounced them legal, an opinion that is newsworthy but certainly not binding on local law enforcement or the courts.

As I've discussed before, the legality of cities' taxes on video sweepstakes is currently under review by North Carolina courts. In the spring of 2012 the N.C. Court of Appeals issued rulings that upheld the cities' authority to tax video sweepstakes but left open the question of how high those taxes can rise before they become unconstitutional. One of those cases is now pending before the N.C. Supreme Court and another was sent back to the trial court, meaning more case law on the tax issue is sure to arrive sometime this year.

So what's a local government to do about video sweepstakes amidst all of this uncertainty?

First, local law enforcement needs to determine how it plans to enforce the newly effective ban. Just as they do with any other potentially illegal activity, law enforcement officers and prosecutors should take a look at local video sweepstakes operators that remain in business and decide whether they are operating legally. If not, law enforcement would be obligated to enforce the ban by issuing criminal citations.

Second, local government tax and zoning officials generally should pretty much continue with business as usual. It might be appropriate for tax and zoning officials to inform video sweepstakes operators seeking zoning permits or privilege licenses of the newly enforceable criminal ban. But these officials should not be charged with the responsibility of determining if these applicants are violating the ban; that's the role of law enforcement. Unless and until a particular video sweepstakes operator is found to be violating the ban, zoning and tax officials should assume that they are legal and proceed as they would for any other business. And city privilege license taxes remain legal unless we get contrary guidance from the N.C. Supreme Court. (For more details on how the criminal ban might affect zoning regulations, please see this excellent post from my colleague Rich Ducker.)

Third, cities who levy privilege license taxes on video sweepstakes operators should not provide refunds to businesses that close in response to the ban unless the tax ordinance for a particular city calls for partial-year refunds—and no ordinances of which I am aware contain refund provisions. Cities don't generally refund taxes to businesses that close mid-year due to fires or bad economies or other reasons; they shouldn't refund taxes to businesses that close due to a change in the law either. If a city were to provide a refund to video sweepstakes operators when its tax ordinance does not call for refunds, that action could constitute an illegal use of public funds.

Absent a provision for refunds in your city's tax ordinance, I think the only situation in which a refund might be justified is after an operator who paid a city tax is convicted of violating the ban on video sweepstakes. G.S. 14-307 prohibits local taxes on illegal gambling machines, meaning if a city taxed illegal gambling those taxes were probably illegal themselves. But right now there isn't a single video sweepstakes operation that has been found to be operating illegally. And G.S. 14-307 doesn't justify a refund of privilege license taxes simply because a video sweepstakes operator *might* have been operating illegally.

Finally, local governments should stay tuned for more legal and legislative developments concerning video sweepstakes. This story is far from over.

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