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The Impact of Gaming Tax Rates on Casino and Racino Development and Operations

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Revenue from gaming taxes in the U.S. benefits education, public safety, economic development, and infrastructure improvements, among other state and local programs. Every year legislative bills and ballot initiatives are introduced that include some reference to raising revenues via the gaming industry to help cover budget shortfalls, either through expansion of legalized gaming or by increasing gaming tax rates[1]. As states consider enactment of such measures, it is important to recognize the impact of the rate at which gaming revenues are taxed.

Gaming Tax Rates and Revenues

According to the American Gaming Association, in the 11 states with non-Native American commercial casinos (private sector land-based, riverboat, and dockside casinos, as well as racetrack casinos in Iowa and Louisiana) in operation in 2006, commercial casinos contributed more than $5.2 billion in tax revenue to state and local governments, a 5.5% increase over 2005 data. Through the third quarter 2007, commercial casino tax revenues for Nevada, the state with the largest commercial casino tax revenues, was approximately $641 million, an increase of 4.3% over the same period in 2006. The gaming tax rates for the states with commercial casinos are set forth in Table 1.

Throughout the 1990s, horse and dog racetracks across the county experienced declining wagering and revenues as a result of fading interest in these

Table 1 - Commercial Casino Tax Rates

State	Tax Rate
Colorado	Graduated up to 20% of gross gaming revenue
Illinois	Graduated from 15% to 50% of gross gaming revenue and $2-$3 admission tax
Indiana	Graduated from 15% to 40% of gross gaming revenue and $3 admission tax
Iowa	Graduated up to 22% of gross gaming revenue
Kansas(1)	Up to 27% of gross gaming revenue
Louisiana	Riverboats: 21.5% and 4% to 6% to local authorities of gross gaming revenue; Land-based: $60 million or 21.5% or gross gaming revenue, whichever is greater
Michigan	24% of gross gaming revenue
Mississippi	Graduated on first $134,000 of gross gaming revenue, 8% on gross gaming revenue over $134,000 plus up to 4% of gross gaming revenue to local governments
Missouri	20% of gross gaming revenue and $2 admission tax
Nevada	Graduated with 6.75% maximum plus approximately 1% additional fees and levies
New Jersey	8% of gross gaming revenue plus community investment alternative obligation of 1.25% or investment alternative of 2.5% gross gaming revenue, 4.25% on casino complimentaries
Pennsylvania	55% of gross gaming revenue
South Dakota	8% tax on gross gaming revenue and gaming device tax of $2,000

(1)Legislation approving commercial casinos is being challenged in the Kansas Supreme Court.

[1]Pennsylvania and Kansas have approved gaming facilities in recent years. Massachusetts is moving toward permitting casinos for the first time, a change that could lead to more casinos throughout New England. In Maryland, voters will consider whether to allow slot machine casinos in November. The legislature in Kentucky is gathering information to draft gaming legislation. Additionally, petitions seeking an increase in Nevada's gaming tax are pending, including a petition by the Nevada State Education Association seeking to increase the gaming tax for commercial casinos with over $1 million in gaming revenues via a ballot initiative from 6.75% to 9.75%.

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facilities as well as the increase in alternative gaming venues. Due to the importance of the racing, breeding, and wagering industry to states, and in order to generate additional funding, several states have authorized gaming machines at racetrack facilities. Racetrack casino operations, commonly referred to as "racinos", are hybrids of casinos, lotteries, and pari-mutuel facilities. For the most part, racinos compete only modestly for patronage from consumers that are closer to other gaming venues that are more established, have more amenities, and often times can offer better comps due to lower revenue sharing/ tax requirements. Generally, customers of the racino facilities choose to patronize a particular racino due to its relatively convenient location and the hybrid gaming venue appears to have given new life to a declining industry.

Proceeds from racino gaming machines contribute significantly to the state budgets, as well as race purses, breeders, and others. In the 11 states with racinos in operation in 2006, racinos contributed more than $1.44 billion in tax revenue to state and local governments, a 12.5% increase over 2005 data. The increase in 2006 was a result, in part, of the legalization of racinos in Pennsylvania and Florida and the opening of three new racinos in New York. The percentage of gaming machine revenues retained by racetrack operators following deductions for taxes and other distributions for the states with racinos is set forth in Table 2.

There is a significant difference in the percentage of gaming machine revenues retained by racetrack operators in states where gaming machines are operated by the state lottery ("Video Lottery Terminals" or "VLTs") versus states in which gaming machines are operated privately. States that operate VLTs include Delaware, New York, Rhode Island, and West Virginia. Where VLTs are operated by the state, the lottery commission takes in revenues, and generally bears a portion of the departmental expenses, before making distributions to stakeholders such as track owners, breeders, and others.

Impact of Gaming Tax Rates on Development

Casino size and volume of casino business are impacted by the amount of direct gaming taxes charged by states and local governments. The economic impact of any gaming facility is dependent upon the extent to which it is successful in drawing visitors from other markets or keeping local residents from spending gambling and/or leisure budgets in other jurisdictions. Larger, attractive casino-resorts that feature additional amenities are in a better position to generate visitation, thus generating more tax revenues. Larger developments will also result in higher real property taxes in some jurisdictions.

Higher gaming tax rates deter casino development and capital investments. Lower gaming tax rates in destination gaming markets, such as Las Vegas and Atlantic City, help to drive development and stimulate economic growth; in addition these markets benefit greatly from revenues generated from visitation from non-local patrons. Gaming companies are more selective in bidding for gaming licenses in emerging domestic markets, and are less likely to expand or develop ancillary facilities, in markets with higher gaming tax rates. Where expansion occurs and ancillary facilities are developed, additional jobs and tax revenues are generated.

Large-scale projects may not be feasible if gaming tax rates represent a large percentage of gross gaming revenue. For example, in states with high gaming tax/contribution rates, such as New York (where racetrack operators retain a vendors' fee of only 32% of the first $50 million of gross VLT revenue, 29% of the next $100 million of gross VLT revenue, and 26% of revenue in excess of $100 million), the feasibility

Table 2 - Gaming Revenue Retained by Racetrack Operator

State	Gross Gaming Revenue Retained by Operator
Delaware	48%
Florida	Less than 50%
Indiana	Up to 56%
Iowa	76.3%
Kansas[1]	25.0%
Louisiana	63.6%
Maine	51.8%
New Mexico	54.75%
New York	Up to 32%
Oklahoma	59.0%
Pennsylvania	45.0%
Rhode Island	27.6%
West Virginia	42.4%

[1]Legislation approving racetrack casinos is being challenged in the Kansas Supreme Court.

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of expanding facilities based on expected net gaming revenues alone is curtailed significantly.

Impact of Gaming Tax Rates on Operations

The amount of contribution to government coffers from gaming entities is not solely determined by the rate at which gaming revenue is taxed. Depending on the jurisdiction, gaming participation may stimulate room tax, sales and use tax, entertainment tax, employment tax, and/or liquor tax. Higher gaming tax rates in one jurisdiction create an advantage for gaming venues located in nearby competing jurisdictions with lower rates. Gaming entities in jurisdictions that have higher gaming tax rates have fewer resources for marketing and complimentaries than competitive gaming venues that operate in jurisdiction that have lower tax rates. In general, casino and racino visitation is expected to be reduced by lower marketing budgets and fewer complimentaries offered to patrons.

Often times, commercial casino and racino facilities must compete with Native American casinos that do not pay state gaming taxes. The Indian Gaming Regulatory Act of 1988 (IGRA) requires revenues from Native American facilities to be used for providing for the general welfare of their people, including tribal government programs and operations, promotion of economic development, and charitable organizations, and tribes must comply with applicable compact provisions, if any. However, in some jurisdictions the ability of commercial casino and racino gaming entities to compete with Native American casinos is inhibited significantly due to the disproportionate burden created by the rate of state and local gaming taxes. Although the disadvantage may be mitigated by a particular property's location, customer base, or other competitive advantage, in general, the end result deprives the state and local governments of gaming taxes that would result from incrementally increased gaming revenues.

It should also be noted that gaming entities cannot absorb increases in gaming taxes by passing the increases onto their patrons, as other industries can, without changing the rules of the games. While slot machine hold percentages can be increased until limits created by law are reached or whatever the market can bear, table games cannot be adjusted to reflect this increase in operating cost. Thus, increases in gaming tax rates often result in gaming entities cutting expenses, i.e., services, employees, and benefits, thereby reducing ancillary taxes, and/or suffering lower profit margins.

Simply comparing the different gaming tax rates between jurisdictions is not necessarily the appropriate basis on which to approach the establishment or increase of gaming tax rates. For example, in Nevada, the state with the lowest gaming tax rate, a free-market approach toward gaming is taken and the casinos are the primary driver of the economy. Other states, such as Michigan and Pennsylvania, choose to limit competition and gaming development, thereby justifying a higher gaming tax rate.

An individual jurisdiction's view of the taxation of gaming enterprises should take into consideration marketwide factors and dynamics and, ultimately, should depend on its policy toward the industry, i.e., as a growth engine or merely a fiscal resource. In some cases, overhaul of states' tax policy may be the appropriate avenue, rather than the quick-fix solution of simply raising gaming tax rates, to address budgetary concerns.

About the Author

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