

## CITY COUNCIL AGENDA ITEM

CITY OF SHORELINE, WASHINGTON

<b>AGENDA TITLE:</b> Review of Gambling Tax Rate
<b>DEPARTMENT:</b> Finance
<b>PRESENTED BY:</b> Debbie Tarry, Finance Director

### PROBLEM/ISSUE STATEMENT:

The City of Shoreline currently implements a gambling tax on the following activities:

- Bingo or raffles at a rate of five percent on the gross revenues less the amount paid in prizes.
- Amusement games at a rate of two percent on the gross revenues less the amount paid as prizes
- Non-Charitable punchboards and pull-tabs at a rate of five percent of gross receipts
- Charitable punchboards and pull-tabs at a rate of 10 percent of gross receipts from operation of the games less the amount awarded as cash or merchandise prizes.
- Social card game rooms licensed under the provisions of RCW 9.46.0325 at a rate equal to 11 percent of the annual gross receipts exceeding \$10,000. It should be noted that the definition of annual gross receipts means "Net Win" for house-banked card rooms. "Net win" describes the total money taken in by the house-banked card room, less the amounts paid out in winning hands. For non-house-banked card rooms, gross receipts includes per hand fees, rakes and other fees collected.

During the November 22, 2004 City Council meeting, the City Council directed staff to develop a plan to analyze whether the current gambling tax on card rooms should be changed. This was in response to the request of current casino owners/operators. These owner/operators claim that their businesses are currently not profitable and have requested that the City Council consider reducing the gambling tax on their card room activities for a year or two.

### ALTERNATIVES:

#### 1. Status-Quo

The City Council can direct staff to do no further analysis of the City's card room activity and continue to assess the 11% tax on card room activity.

#### 2. Further Review of City Card Room Activity

- A. City Council can direct staff to proceed with further analysis of any available audited financial statements from the City's major card rooms. Audited financial statements have been requested from the Washington State Gambling Commission (WSGC), but only those card rooms with gross receipts in excess of \$5 million annually have been required to submit audited financial statements to

the WSGC prior to 2004. The City would engage a CPA firm with expertise in the gaming industry to assist with the review of the financial statements.

- B. The City Council can direct staff to proceed with further analysis of audited financial statements and supporting schedules of the City's major card rooms. For those card rooms that don't have audited financial statements available, the City could engage the services of a qualified CPA firm to complete audits.

Under both of these scenarios, staff would provide additional information to the Council on the analysis findings and Council can determine if they would like to change the current 11% tax rate applied to card rooms.

### 3. Change the Card Room Tax Rate Without Further Analysis

The Council could determine, based on the information provided in this staff report, that they have sufficient information to make a determination that the current 11% tax rate should be changed to either a higher or lower rate.

### **FINANCIAL IMPACT:**

The 2005 budget includes nearly \$3 million of revenue from gambling tax. This represents 10% of the general fund revenue. Of the \$3 million, \$2.65 million is estimated to come from card room activity. Each 1% of card room gambling tax equals approximately \$240,000. The 2005 budget allocates \$1.08 million of gambling tax for capital purposes and the remaining \$1.9 million funds general operations. Any reduction in the gambling tax rate would require that either the operating or capital budget be modified as a result of reduced revenue.

Although a scope of work to further analyze audited financial statements or to complete audits will not be developed until further Council direction is received, the estimated cost for review of existing audited financial statements is \$1,000 to \$2,000 per casino, for detailed analysis of the financial statements and supporting schedules it is estimated to cost \$5,000 to \$7,000 per casino and an audit of a casino is estimated at \$15,000 to \$20,000 for each year audited.

### **RECOMMENDATION**

Staff recommends that Council not make any changes to the current card room tax rate for the following reasons: 1) Net gambling tax income for all casinos combined has been steadily increasing since 2001. 2) From a policy perspective it is not an appropriate role for government to determine whether or not casinos are running their businesses efficiently and profitably. 3) It would be difficult, if not impossible, to determine if the lack of profitability is solely due to the City's gambling tax as opposed to market forces or operator decisions. 4) As indicated in the attachment, Shoreline's tax rate on card rooms is well in line with other cities in the region. The 11% rate has not created an "uneven playing field". 5) The existing card rooms have a significant competitive advantage in that no new casinos are allowed in Shoreline; and since card rooms are not allowed in Seattle a significant market area is assured. 6) A reduction of 2% would result in approximately \$480,000 in lost revenue annually; revenue that is critical for essential services and unmet capital needs. Recent voter initiatives such as the \$15.00

motor vehicle tax repeal, the loss of sales tax equalization, and the 1% property tax limitation have all combined to reduce both operational and capital revenues, creating serious challenges as indicated in our financial forecasts.

However, if the City Council would like to pursue further investigation staff recommends alternative 2b which provides for a detailed review of audited financial statements and supporting schedules.

Approved By:      City Manager  City Attorney 

## **INTRODUCTION**

The City of Shoreline currently implements a gambling tax on the following activities:

- Bingo or raffles at a rate of five percent on the gross revenues less the amount paid in prizes.
- Amusement games at a rate of two percent on the gross revenues less the amount paid as prizes
- Non-Charitable punchboards and pull-tabs at a rate of five percent of gross receipts
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- Social card game rooms licensed under the provisions of RCW 9.46.0325 at a rate equal to 11 percent of the annual gross receipts exceeding \$10,000. It should be noted that the definition of annual gross receipts means "Net Win" for house-banked card rooms. "Net win" describes the total money taken in by the house-banked card room, less the amounts paid out in winning hands. For non-house-banked card rooms, gross receipts include per hand fees, rakes and other fees collected.

During the November 22, 2004 City Council meeting, the City Council directed staff to develop a plan to analyze whether the current gambling tax on card rooms should be changed. This was in response to the request of current casino owner/operators that the City reduce the card room tax rate for one or two years. This request appears to be generated by owners who claim that their businesses are not currently making a profit and a reduction in gambling tax would assist them in making their businesses profitable.

## **BACKGROUND**

### **Statewide Gambling Information**

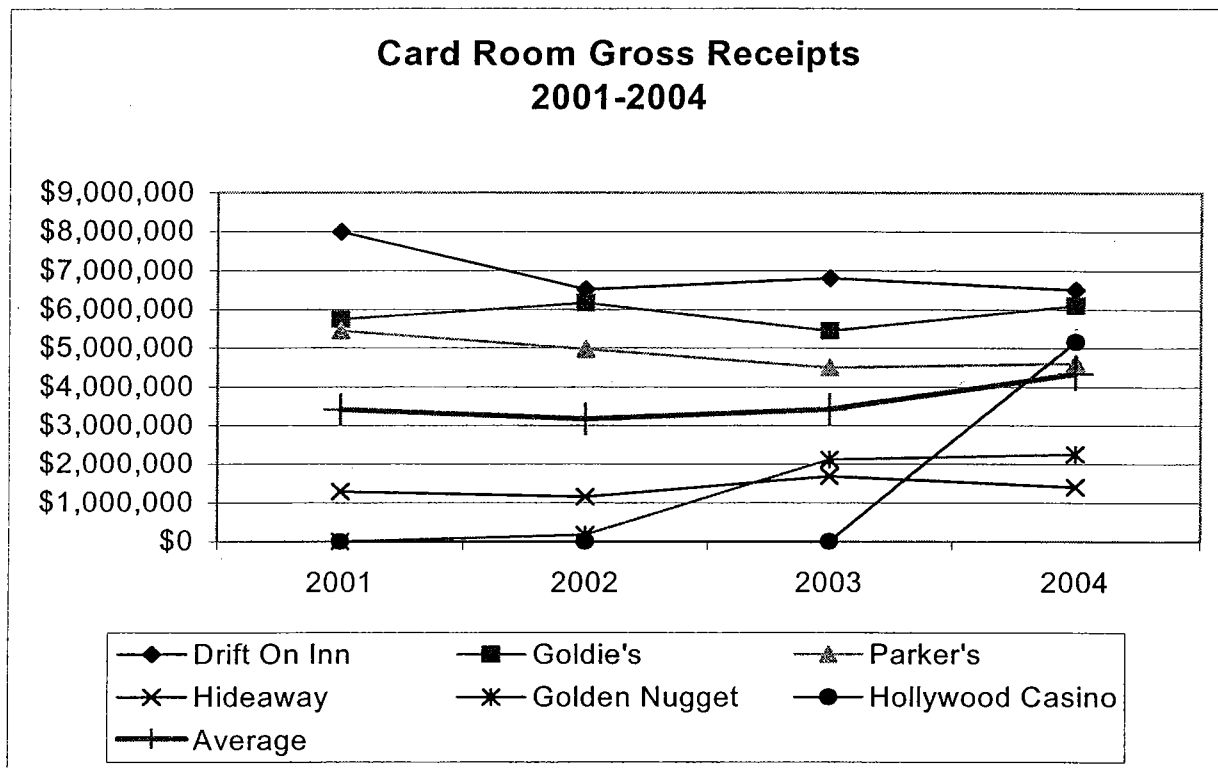
Gambling activity within the State of Washington has grown from a \$863 million dollar industry in 2000 to a \$1.5 billion dollar industry in 2004. Primarily the growth has been in the tribal casinos with gambling activity growing from \$272.6 million in 2000 to an estimated \$888 million in 2004, a 225% increase. At the same time card room activity, on a statewide basis, has increased from \$186.9 million to \$268.4 million, a 44% increase.

### **Local Card Room Activity**

The City currently has six card rooms operating within its jurisdiction. These are: Drift on Inn, Goldie's, Parker's, Hideaway, Golden Nugget, and Hollywood Casino. The gambling tax generated from these card rooms has been fairly stable since 2000, with the annual tax averaging \$2.18 million for 2000 through 2003. In October of 2003 the Hollywood Casino opened and we are estimating annual tax revenues from this casino to be between \$600,000 and \$700,000 annually. Although this may be the case, we wanted to remain conservative and anticipate any reduction in gambling activity for 2005 and estimated 2005 card room gambling tax at \$2.65 million.

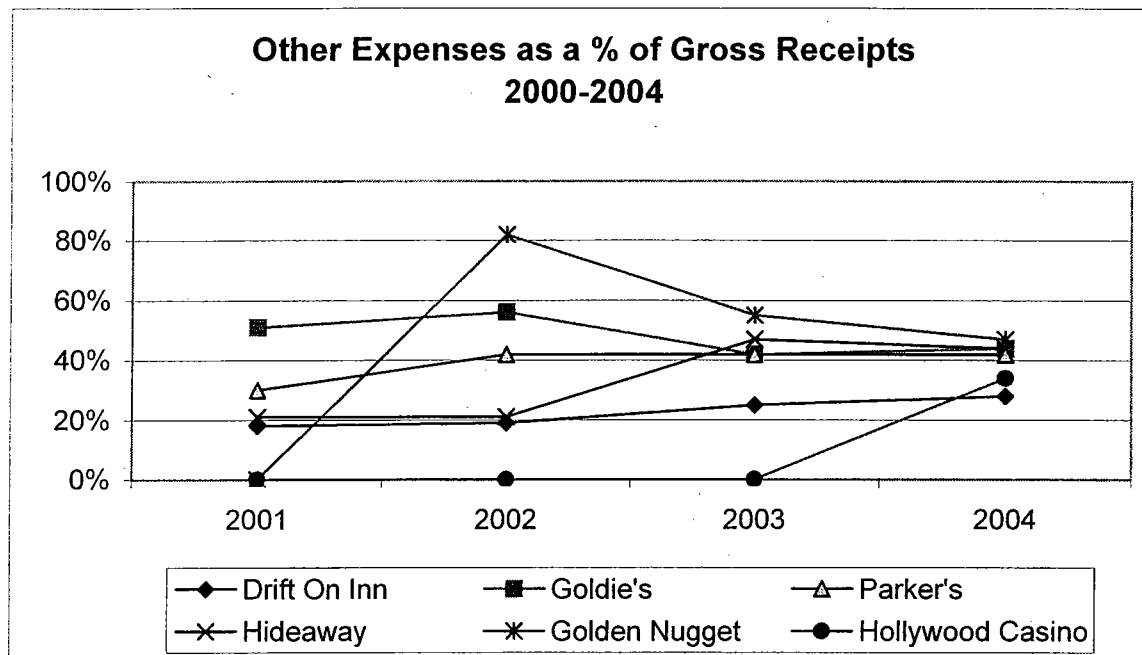
Attachment A is card room statistics for the state fiscal years of 2001 through 2004 based on the information that the casinos provided to the Washington State Gambling Commission (WSGC). This information shows gross receipts, expenses, and net gambling income for each of the casinos. This information only includes revenue and expenses related to the gambling activities for the casino.

Gross receipts for a card room basically means "Net Win" for house-banked card rooms. "Net Win" is the total money taken in less the amounts paid out in winning hands. For non-house-banked card rooms gross receipts is the per hand fees, rakes and other fees collected. The Hideaway is the only non-house-banked card room in Shoreline. When analyzing the WSCG information it appears that the gross receipts generated by the various card rooms, on a whole, have remained fairly constant over the last few years, and in fact would have increased in 2004 even if the Hollywood Casino had not been in operation. At the same time it appears that on an individual basis, activity has shifted between card rooms, for example in 2004 the Drift on Inn gross receipts were lower than 2003, but Goldie's gross receipts increased in 2004 when compared to 2003. The graph below provides a summary of this information.



The information from the WSGC breaks expenses into three main categories: wages, local gambling tax (City portion), and other expenses. Other expenses include the following: supplies, license fees, state and federal taxes, occupancy, equipment, advertising, contract and professional services, and other expenses.

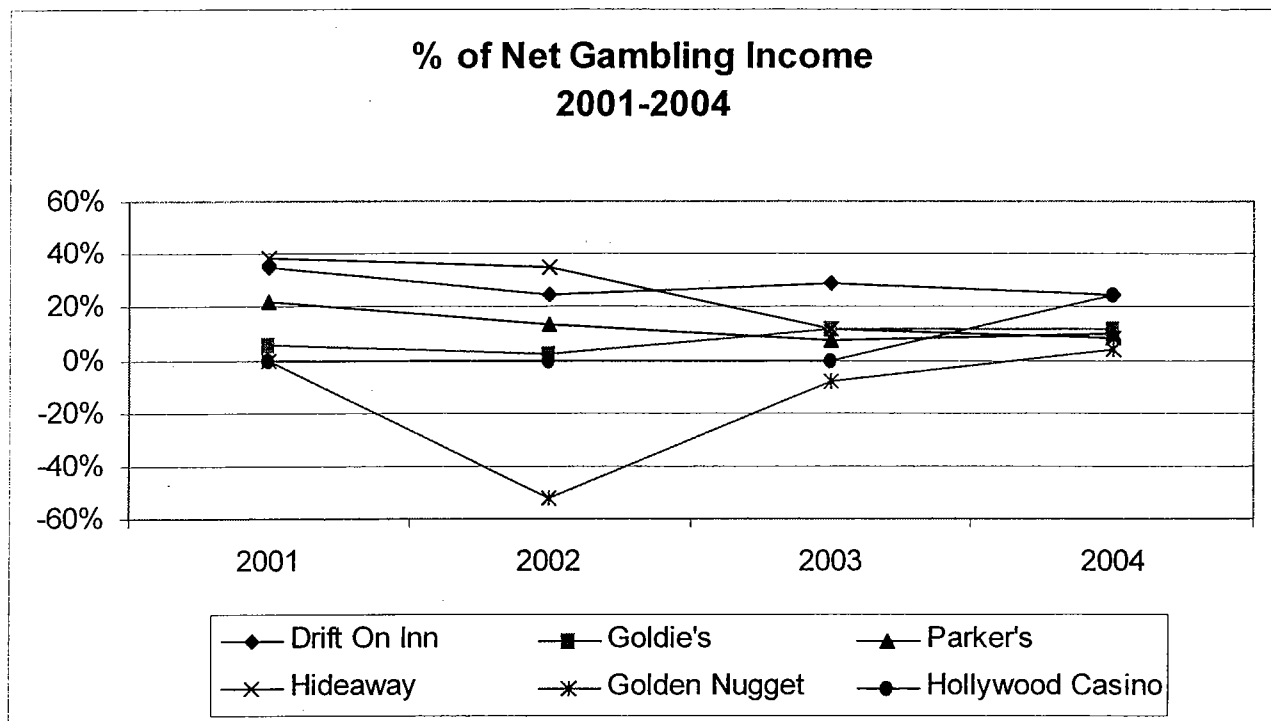
It appears on average most of the casinos are fairly consistent on the amount of their gross receipts that are allocated towards wages, with the average for the last four years varying from 32% to 37%. Golden Nugget has had the most variation in this category. "Other Expenses", on the other hand seems to vary a great deal amongst the card rooms. At this time we don't have itemized detail of the "other expense" category for all casinos, but it is one area that may need further analysis if the City Council wants further analysis of the profitability of the casinos. The following graph shows, by card room, "other expenses" as a percentage of gross receipts for 2000 through 2004.



As the Council can see from this graph, many of the card rooms are more similar in percent of gross revenues allocated for other expenses in 2004, but there is still a large disparity between Drift On Inn and the other card rooms. In 2004 Drift on Inn's other expenses were 28% of gross receipts while most of the other card rooms had 42% to 47% of there gross receipts allocated for other expenses. The Hollywood Casino showed a 34% allocation of gross receipts to other expenses, but this represents only three quarters of operation.

According to the information that we have from the WSGC all casinos had a positive net gambling income in 2004. Net gambling income is defined as gross receipts less winning hands, prizes, wages, taxes and other expenses. The following table and graph show the percentage of net gambling income for each of the casinos for the last four years.

<b>% Net Gambling Income State of Washington Fiscal Year July – June</b>				
<b>Card Room</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Drift On Inn	35%	25%	29%	25%
Goldie's	6%	2%	12%	12%
Parker's	22%	13%	7%	10%
Hideaway	38%	35%	12%	8%
Golden Nugget	N/A	-52%	-8%	4%
Hollywood Casino (3qtrs of Operation)	N/A	N/A	N/A	25%



As you can see from the table and graph the Golden Nugget had net gambling losses in 2002 and 2003, but a positive net income in 2004. The Hideaway appears to have the largest fluctuations in net income, although they have continuously managed to have a positive net gambling income. As indicated in the attached table, the total net gambling income for all casinos was \$4,333,705 in 2004 (with only 3 quarters for Hollywood Casino). While this is down from the \$4,900,710 reported in 2001, it has increased continually from \$2.7 million in 2002 and \$3.1 million in 2003.

#### Further Analysis

An analysis of profitability should include a review of a business's audited financial statements that have been developed in accordance with Generally Accepted Accounting Principles (GAAP). Often further analysis of supporting schedules that are used to develop the financial statements need to be reviewed to fully understand any internal transactions that may affect profitability. It should be noted that tax returns are not the same as financial statements developed in accordance with GAAP. The major objective with tax returns is to minimize tax liability, while GAAP financial statements have the objective of fairly stating the assets, liabilities, net income, and equity of a business. For these reasons, different decisions and methods of showing revenues and expenses can be done between tax returns and financial statements. GAAP financial statements also include notes to the financial statement which often provides more clarification and disclosure about the numbers. For example there could be a real estate transaction or lease that shows as an expense for the casino, but in reality the owner/operator of the casino receives payment under the name of a separate corporation for the casino's real estate.

Prior to 2004 all house-banked card rooms with annual gross receipts in excess of \$5 million were required to develop GAAP financial statements and have them audited by a licensed Certified Public Accountant (CPA) firm. In 2004 new regulations were

approved by the legislature that lowered this threshold to \$3 million. It also requires all house-banked card rooms with gross receipts between \$1 and \$3 million to have their financial statements reviewed by a licensed CPA firm.

Drift on Inn and Goldie's appear to have been required to develop GAAP financial statements and have them audited prior to 2004. In 2004 Parker's and Hollywood Casino will be required to develop GAAP financial statements and have them audited. The Hideaway will be required to have their statements reviewed in 2004. We have submitted a public disclosure request to the WSGC to obtain any audited financial statements that they have for Shoreline casinos. To date we have not received those materials. Financial statements for 2004 are due to the WSGC 120 days after the end of the casino's business year. This means that 2004 statements will probably not be available until the second quarter of 2005.

#### **ALTERNATIVES ANALYZED:**

Basically there are three options that the City Council can choose: 1) Make no change in the current card room tax rate; 2) Direct staff to do further analysis work regarding local casino profitability; or 3) Change the current card room gambling tax rate without further analysis.

1. The Council can choose to leave the current card room tax rate at 11% and not proceed with any further analysis of the casino profitability. This option would not have further expenditure impact on the City. At the same time this would deny the request of casino operators to reduce the tax rate. The City would continue to monitor the card room activity trend and the impacts it may have on the City's gambling tax revenue.
2. Direct Staff to further analyze the profitability of casinos following the receipt of 2004 audited financial statements.
  - 2a. Engage a CPA firm knowledgeable of the gaming industry to help evaluate available audited financial statements. This would allow staff to evaluate the information that is included in the financial statements, but would not necessarily provide full disclosure of any internal transactions that may reveal the full amount of money that an owner is getting from the casino activity. An example would be how much of wage costs are attributed to payments to owner/operators. Staff would need to develop a specific scope of work that would be required by a CPA firm if the Council chooses this alternative, but based on preliminary estimates the estimated cost for financial statement analysis would be \$1,000 to \$2,000 per casino.
  - 2b. Engage a CPA firm knowledgeable of the gaming industry to evaluate audited financial statements and do further analysis of supporting schedules if necessary. This would require authorization from casino owners to provide this information to the City. It would also take more time and effort to do this analysis work. The benefit would be more full disclosure of the profitability or non- profitability of the casino. This is really the only way that a full analysis of profitability can be completed. Preliminary estimates to do this type of analysis would be \$3,000 to \$7,000 per casino. If audited financial statements are not available the Council could request that an audit be completed. The estimated cost for a casino audit is between \$15,000 and \$20,000.

The Council should consider whether it is the appropriate role of the City to evaluate the profitability of the casinos. There are many operational issues and decisions that casino owners and operators can make that can affect profitability. For example a casino may have a business plan that does not come to fruition such as the implementation of electronic gaming devices. Other areas of decision making may be in regards to how the building and land, that the casino is located on, are financed or how casino employees are compensated. Casino operators may choose to spend money on lobbying efforts to have legislation that would benefit their industry and this is an expense that affects the casino bottom line. Competition from other casinos may affect profitability, and at some point there may be a market saturation with some going out of business or consolidating. All of these market conditions and expenditures and owner decisions may affect casino profitability. The Council will need to determine if the City should be in a role to determine whether casinos are running their businesses efficiently and if the sole reason for any lack of profitability is related to the City's gambling tax rate.

3. Change the current 11% card room gambling tax rate without further analysis. The Council can change the gambling rate without further analysis. At this time staff does not recommend a decrease or an increase to the gambling tax rate. The City has realized that gambling tax revenue is subject to economic cycles and therefore has not relied on 100% of the revenue for daily operations. Although this is the case, the gambling tax revenue has been steady over the last few years, with additional revenue being realized in 2004 as a result of the opening of Hollywood Casino. Staff will continue to monitor the gambling tax revenue and monitor any changes we see as a result of changes in gambling activity within the City.

### **RECOMMENDATION**

Staff recommends that Council not make any changes to the current card room tax rate for the following reasons: 1) Net gambling tax income for all casinos combined has been steadily increasing since 2001. 2) From a policy perspective it is not an appropriate role for government to determine whether or not casinos are running their businesses efficiently and profitably. 3) It would be difficult, if not impossible, to determine if the lack of profitability is solely due to the City's gambling tax as opposed to market forces or operator decisions. 4) As indicated in the attachment, Shoreline's tax rate on card rooms is well in line with other cities in the region. The 11% rate has not created an "uneven playing field". 5) The existing card rooms have a significant competitive advantage in that no new casinos are allowed in Shoreline; and since card rooms are not allowed in Seattle a significant market area is assured. 6) A reduction of 2% would result in approximately \$480,000 in lost revenue annually; revenue that is critical for essential services and unmet capital needs. Recent voter initiatives such as the repeal of the \$15.00 motor vehicle tax, the loss of sales tax equalization, and the 1% property tax limitation have all combined to reduce both operational and capital revenues, creating serious challenges as indicated in our financial forecasts.

However, if the City Council would like to pursue further investigation staff recommends alternative 2b which provides for a detailed review of audited financial statements and supporting schedules.

**ATTACHMENTS**

Attachment A – Card Room Statistics 2001-2004

Attachment B – Comparison of Gambling Tax Rates

# Card Room Statistics 2001-2004

Establishment	State Fiscal Year (July-June)	Gross Receipts	Special Prizes	Net Receipts	Gambling Wages	% of Gross Receipts	Reported Local Tax	% of Gross Receipts	Other Gambling Expenses	% of Gross Receipts	Net Gambling Income	% Net Gambling Income
Drift on Inn - House Banked	2001	7,996,700	-	7,996,700	2,871,617	36%	879,527	11%	1,412,257	18%	2,833,299	35.43%
	2002	6,518,614	55,351	6,463,263	2,868,823	44%	714,848	11%	1,237,588	19%	1,842,004	25.19%
	2003	6,809,635	149,714	6,659,921	2,213,762	33%	769,447	11%	1,669,028	25%	2,007,684	29.48%
	2004	6,508,354	137,355	6,370,999	2,227,246	34%	714,145	11%	1,818,318	28%	1,611,290	24.76%
	Average	6,958,326	85,605	6,872,721	2,545,362	37%	769,492	11%	1,534,298	22%	2,023,569	28.72%
% Change 2001-2004		-18.61%		-20.33%	-22.44%	-5%	-18.80%		28.75%	58.20%	-43.13%	
Goldie's Shoreline Casino - House Banked	2001	5,742,653	-	5,742,653	1,845,236	32%	630,658	11%	2,902,927	51%	363,832	6.34%
	2002	6,167,088	-	6,167,088	1,928,005	31%	845,453	11%	3,456,052	56%	137,578	2.23%
	2003	5,789,256	-	5,789,256	1,992,238	34%	636,818	11%	2,447,961	42%	712,239	12.30%
	2004	6,103,135	37,530	6,065,605	1,982,949	32%	667,931	11%	2,857,702	44%	757,023	12.40%
	Average	5,950,533	9,383	5,941,151	1,937,107	33%	645,215	11%	2,866,161	48%	492,668	8.32%
% Change 2001-2004		6.28%		5.62%	7.46%	1%	5.91%		-8.45%	-13.86%	108.07%	
Parker's Sports Bar & Casino - House Banked	2001	5,441,323	-	5,441,323	1,980,830	36%	597,456	11%	1,655,478	30%	1,207,559	22.19%
	2002	4,978,689	35,300	4,943,389	1,652,859	33%	526,201	11%	2,093,842	42%	670,487	13.47%
	2003	4,493,603	83,150	4,410,453	1,701,609	38%	503,068	11%	1,884,133	42%	321,643	7.16%
	2004	4,608,727	36,025	4,572,702	1,660,939	36%	518,417	11%	1,923,225	42%	470,121	10.20%
	Average	4,860,586	38,619	4,841,967	1,749,059	36%	536,286	11%	1,869,170	39%	667,453	13.25%
% Change 2001-2004		-15.30%		-15.96%	-16.15%	-1%	-13.23%		16.17%	37.16%	-61.07%	
Hideaway	2001	1,290,360	-	1,290,360	380,819	30%	140,840	11%	272,681	21%	496,020	38.44%
	2002	1,157,487	-	1,157,487	378,401	33%	127,324	11%	248,386	21%	403,376	34.85%
	2003	1,683,627	-	1,683,627	512,583	30%	171,617	10%	790,930	47%	208,497	12.38%
	2004	1,398,567	43,509	1,355,058	478,084	34%	149,607	11%	612,085	44%	115,282	8.24%
	Average	1,382,510	10,877	1,371,633	437,472	32%	147,347	11%	481,021	35%	305,794	23.48%
% Change 2001-2004		8.39%		5.01%	25.54%	16%	6.22%		124.47%	107.10%	-76.76%	
Golden Nugget - House Banked	2001	177,278	-	177,278	105,504	60%	18,401	10%	145,299	82%	(91,926)	-51.85%
	2002	2,111,824	-	2,111,824	911,490	43%	203,837	10%	1,165,229	55%	(168,732)	-7.99%
	2003	2,254,474	-	2,254,474	863,773	38%	242,026	11%	1,065,196	47%	83,479	3.70%
	2004	1,514,525	-	1,514,525	626,922	41%	154,755	10%	791,908	52%	(59,060)	-18.71%
	Average	1,514,525	-	1,514,525	626,922	41%	154,755	10%	791,908	52%	(59,060)	-18.71%
% Change 2003-2004		6.75%		6.75%	-5.24%	-11.23%	18.74%		-8.58%	-14.37%	-149.47%	
Hollywood Casino - House Banked	2001	5,165,765	7,859	5,157,906	1,560,334	30%	566,033	11%	1,735,029	34%	1,296,510	25.10%
	2002	-	-	-	-	-	-	-	-	-	-	-
	2003	-	-	-	-	-	-	-	-	-	-	-
	2004	-	-	-	-	-	-	-	-	-	-	-
	Average	5,165,765	7,859	5,157,906	1,560,334	30%	566,033	11%	1,735,029	34%	1,296,510	25.10%
% Change 2001-2004												
Totals	2001	20,471,036	-	20,471,036	7,078,502	34%	2,248,481	11%	6,243,343	30%	4,900,710	24.43%
	2002	18,999,156	-	18,999,156	6,933,592	36%	2,032,227	11%	7,181,167	37%	2,761,519	14.54%
	2003	20,887,945	-	20,887,945	7,331,682	35%	2,284,787	11%	7,957,281	38%	3,081,331	14.76%
	2004	26,039,022	-	25,776,744	8,773,325	33%	2,858,159	11%	9,811,555	38%	4,333,705	16.63%
	Average	27,200		25,926	23,944		27,126		57,155		-11,576	

Note: Revenues and expenses are for gambling purposes only, and do not reflect all operating costs of non-gambling portions of the business or organizations.

\*Gross Receipts\* include funds from three types of card room activities: a) chair rental fees, b) per hand fees, c) rake and other fees collected in non-house-banked

card rooms (starting July 1996), and d) "net win" in house-banked card rooms (starting July 1997)

\*Net Win\* describes the total money taken in by house-banked card rooms, less the amounts paid out in winning hands.

\*Special Prizes\* include tournament awards, but NOT winning hands from house-banked card rooms. Those winning hands already deducted to get Net Win

and Gross Receipts.

### Comparison of City Gambling Tax Rates

City	Card Game Tax Rate	Local City B&O Tax Rate	\$\$ Generated by the City B&O Tax
Auburn	12.00%		
Bellevue	Not Allowed		
Bothell	Not Allowed		
Burien*	11.00%	0.0500%	\$2,007
Edmonds	Not Allowed		
Everett*	10.00%	0.1000%	\$13,516
Federal Way	20.00%		
Kenmore**	15.00%		
Kent	10.00%		
Kirkland	Not Allowed		
Lakewood	11% to 20%***		
Lake Forest Park	Not Allowed		
Lynnwood	Not Allowed		
Mountlake Terrace	10.00%		
Redmond	12.00%		
Renton	10.00%		
SeaTac	10.00%		
Seattle	Not Allowed		
Spokane	20.00%		
Tacoma*	11.00%	0.4000%	\$19,049
Tukwila	10.00%		

\* Cities that assess a City B&O tax in addition to a gambling tax

\*\*Rate increased on 12/13/2004

\*\*\* Rate dependent on total monthly gross revenue