

CITY COUNCIL AGENDA ITEM
CITY OF SHORELINE, WASHINGTON

AGENDA TITLE: Ordinance No. 375, Implementing a Six Month Reduction in Social Game Card Room Gambling Tax Rate to 10% Effective April 1, 2005
DEPARTMENT: Finance
PRESENTED BY: Robert Olander, Deputy City Manager
Debbie Tarry, Finance Director

PROBLEM/ISSUE STATEMENT:

On February 7, 2005, the City Council passed a motion to direct staff to draft an ordinance that would provide for a six month reduction in the social game card room gambling tax rate from 11% to 10%. During the six month period the City Council directed staff to do further analysis of the profitability of Shoreline casinos by reviewing audited financial statements and any necessary supporting schedules.

FINANCIAL IMPACT:

A 1% six month reduction in the City's social card game room gambling tax rate is estimated to reduce the City's revenues by \$120,000 in 2005. If the City Council determines that a longer-term gambling tax rate reduction is desired then for each 1% annual reduction in card room gambling tax the City's revenues would be expected to drop by approximately \$240,000.

In addition to the anticipated revenue reduction, the City will incur some costs to complete the additional analysis of casino profitability. This is primarily a result of anticipated professional services needed from Moss Adams. If all casinos are able to provide audited and/or Certified Public Accountant (CPA) reviewed financial statements, staff expects that the cost for the additional analysis will be in the range of \$5,000 to \$10,000. If the casinos do not provide all the requested information or we find that additional audit work is needed to complete the analysis the costs will be greater. Since this was not a budgeted work item, staff will shift monies from other projects to complete the gambling analysis.

RECOMMENDATION

Staff recommends that Council approve Ordinance No. 375 (Attachment A)

Approved By: City Manager  City Attorney 

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INTRODUCTION

The City of Shoreline currently implements an 11% gambling tax on social card rooms. This has been the case since the City incorporated, as the City adopted the King County regulations and 11% was the tax rate at that time. King County continues to tax social card games at the 11% tax rate.

In November 2004 several of the casino operators approached the City Council requesting that the City reduce its gambling tax rate on social card rooms for a one to two year period. The casino operators have said that their businesses are not profitable and therefore a reduction in tax rate would assist them in becoming profitable.

BACKGROUND

Since incorporation the City has assessed an 11% gambling tax on social card rooms. Knowing that this revenue was susceptible to economic cycles the City Council has not relied on the total amount of gambling tax collected for daily operations. The City Council has implemented a policy of allocating an amount equal to 64% of the gambling tax collected for operations and 36% for capital purposes. Historically the City has allocated the capital portion towards transportation projects. For 2005 this means that of the budgeted card room gambling tax of \$2.6 million, an amount equal to \$954,000 has been allocated towards capital and \$1.7 million towards general operations.

On January 10, 2005, staff provided information to the City Council regarding the gambling portion of each casino's business operation and options they could choose if they desired more analysis. Review of this information by the City Council was delayed until February 7, 2005, as a result of the length of the Council Meetings and at the request of one of the casino operators to delay the discussion on the night of January 24, 2005.

On February 7, 2005, the City Council directed staff to prepare an ordinance that would provide a six month reduction in the card game gambling tax rate to 10% and that during the six month time period staff do further analysis on the profitability of each of the casino's business operations.

Casinos are required to report on their gambling activities and remit their gambling tax to both the State of Washington and the City within 30 days following a calendar quarter. The casinos are not required to segregate quarterly activity into individual months. For this reason the attached ordinance will be effective April 1, 2005, the beginning of the second quarter. The casino operators have concurred that this is the most logical implementation date.

DISCUSSION

Additional Analysis of Casino Profitability

Council has requested that staff do additional analysis on the profitability of casino operations. This analysis will include a review of the entire casino operation in addition to the gambling portion of their business. This may include food and beverage operations, other gambling activities such as pull-tabs, and other supporting business

lines. In order to do this analysis we will be requesting that the casinos provide us with audited financial statements that have been prepared in conformance with generally accepted accounting principles (GAAP).

GAAP financial statements require that revenues and expenditures be accurately reflected to account for the true profitability of a business. They also include required disclosure within the financial statement notes of any related party transactions. Attachment B of this staff report is some general information regarding related party transactions that was provided by Roy Cupler of Moss Adams. Since monies that are paid to related third parties show as expenditures and/or liabilities on financial statements they may make a casino look less profitable on the face of the statement, but in reality the money is being paid to owners and is a form of return on investment of the casino operation. Non GAAP financial statements and federal tax returns (IRS returns) do not accurately reflect the financial operations of a business and should not be the source for determining the profitability of the casinos. These statements are not required to disclose related party transactions.

Prior to 2004 only casinos that had gross receipts of \$5 million or more were required to have audited GAAP financial statements. This requirement only applied to two of the casinos located within Shoreline for the last few years: Goldie's and Drift on Inn. Parker's casino did exceed the \$5 million threshold in 2001 and therefore should have audited GAAP statements for that year. In 2004 a new state law was adopted that reduced the audit requirement to \$3 million and for those casinos with gross receipts in excess of \$1 million to have their GAAP statements reviewed by a licensed CPA. All of the casino's located in Shoreline had gross receipts in excess of \$1 million in 2004.

Staff has already requested all casinos to provide the City a copy of either audited or reviewed GAAP financial statements for 2004. Additionally we have requested that any casino that has audited GAAP statements prior to 2004 to provide us with those for years 2001 through 2004. Both Goldie's and Parkers have told us that they expect their 2004 statements and audit to be completed sometime during April. We are still confirming with the other casinos when their statements will be available.

We have also engaged the services of the Tacoma Office of Moss Adams to assist us in the additional analysis of casino profitability. They are providing our staff with a template that we can use to enter information from the financial statements in order to standardize the information and make further analysis more efficient. We anticipate that Moss Adam's expertise will be needed as we evaluate related party transactions, lease and financing disclosures, and other portions of the casino operations. If the casinos are able to provide us with the requested information we anticipate that the Moss Adam's contract will not exceed \$10,000. If the information from the casinos is not provided, incomplete, or leads to the need for further research/analysis this cost estimate may increase.

If we are able to obtain all the requested financial statements by the end of April, staff would hope that most of the analysis work could be completed by the end of June, if not before. Again this is dependent on the casinos providing the information to the City and being available to respond to questions as we review their information. We would hope

to bring forward our findings to the City Council in July so that Council can review the information prior to their break in August.

We would hope that this would give Council enough time to determine if they would like to take any additional actions prior to the expiration of the six month tax reduction period in September.

In addition to the current analysis the City Council directed staff to establish a regular review of profitability of casinos in Shoreline. As staff completes the current review, we will have a better understanding of the staff resources and support services needed to complete the analysis on a regular basis. We would anticipate making a recommendation to Council, when we share the findings of the current year analysis in July, as to whether the City should pursue a regular review on a two or three year cycle.

Six Month Reduction in Card Room Gambling Tax Rate

Ordinance No. 375 implements a six month reduction in the card room gambling tax rate from 11% to 10%. The six month period begins on April 1, 2005, and sunsets on September 30, 2005. If Council takes no additional action, the card room tax rate will return to 11% effective October 1, 2005.

Ordinance No. 375 also provides a clause that if the State implements a gambling tax on card rooms that is in addition to the City's tax and that would direct the 1% rate reduction made by the City to the State, that the rate reduction immediately cease and the City's rate would be increased back to the 11% tax rate. Senate Bill 5287, currently being considered by the Legislature, would implement a 10% state card room tax in addition to any amount assessed by a City up to a maximum of 20%. If the City did not raise its rate back to 11% prior to the effective date of the State gambling tax legislation, the 1% of tax previously collected by the City would now be collected by the State. This revenue would no longer be available to fund local operations, even though the casino operations create needs for local services.

As discussed earlier in this staff report, a six month 1% tax rate reduction is anticipated to reduce 2005 revenues by \$120,000. At this time staff is recommending that any revenue reduction related to the reduction in tax rate be offset by a reduction in the transfer of gambling tax monies to capital.

If the Council determines that either they want a longer term tax rate reduction or a greater tax rate reduction, further reductions in the capital allocation of gambling tax or operational budget reductions will be necessary. The current adopted 2005-2010 Capital Improvement Program (CIP) is balanced with the assumption of approximately \$1.1 million annually, \$6.7 million over the six year period, of gambling tax monies being allocated for transportation projects. If the Council were to approve the 1% reduction on an ongoing basis, and if the \$240,000 annual revenue reduction was reflected in a reduction to the capital allocation, the six year amount of gambling tax allocated to the CIP would fall from \$6.7 million to \$5.2 million, creating a \$1.5 million dollar gap. In addition to this Council is currently reviewing the recommended Transportation Master Plan. This plan recommends funding approximately \$126 million in transportation projects over the next 20 years, of which gambling tax represents \$22 million in revenue sources to complete these projects. If the allocation of gambling tax to the

transportation capital program is reduced by the 1% tax rate reduction, the 20 year allocation will fall to \$17.4 million, a \$4.7 million dollar reduction.

If, on the other hand, a reduction in gambling tax rate were to be reflected as a reduction of operating budget revenues, the City's long-term financial gap would be greater. In 2004 the City Manager proposed a long-term financial plan to address this anticipated gap. Either additional service reductions or other alternative revenues would need to be added to this plan in order for the City to balance it's long-term operational budget.

STAKEHOLDERS

Staff has contacted all of the casino operators both by phone and by written correspondence to explain the actions that the Council has taken to date. As mentioned earlier in this report we have also requested audited and/or reviewed GAAP financial statements for years 2001 through 2004. Goldie's has already provided statements for years 2001 through 2003. Both Goldie's and Parker's have indicated that their 2004 audited statements should be available sometime during April of this year. We are still confirming with the other casinos on when their GAAP statements will be available (Drift on Inn, Club Hollywood, Golden Nugget and The Hideaway – although closed). As stated earlier in this report, we are requesting audited or reviewed GAAP statements. Although some casinos may have Income Tax Returns or non-GAAP profit and loss statements, those are not acceptable to evaluate the profitability of their businesses.

SUMMARY

Ordinance No. 375 will implement a six month reduction in card room gambling tax rate from 11% to 10% effective April 1, 2005. During this six month period staff will be working with the casinos and Moss Adams to complete further analysis of individual casino profitability and we anticipate bringing our findings back to Council during July.

RECOMMENDATION

Staff recommends that Council approve Ordinance No. 375

ATTACHMENTS

Attachment A – Ordinance No. 375 reducing the City's card room gambling tax from 11% to 10% for a six month period beginning April 1, 2005.

Attachment B – Information about Related Party Transactions

ORDINANCE NO. 375

AN ORDINANCE OF THE CITY OF SHORELINE, WASHINGTON, ADOPTING A SIX MONTH REDUCTION IN THE CITY GAMBLING TAX ON SOCIAL CARD ROOMS TO 10% OF GROSS RECEIPTS; AMENDING SHORELINE MUNICIPAL CODE 3.30.020; AND PROVIDING A SUNSET OF THE TAX REDUCTION .

WHEREAS , the City Council received requests from Shoreline card room operators during preparation of the 2005 budget asking for a reduction in the City's gambling tax; and

WHEREAS, City staff will conduct a study to investigate the operators' claim that the tax rate of 11% threatens the continued profitability of operating licensed card rooms; and

WHEREAS, the Council finds there is a sufficient showing that the current tax rate may result in unprofitable operations and the gambling tax rate should be reduced pending the results of an analysis of profitability of current casino business operations in the City; NOW, THEREFORE,

THE CITY COUNCIL OF THE CITY OF SHORELINE, WASHINGTON, DO ORDAIN AS FOLLOWS:

Section 1. Amendment in effect from April 1, 2005 to September 30, 2005.

Shoreline Municipal Code section 3.30.020 is amended as follows for the period April 1, 2005 to September 30, 2005:

3.30.020 Imposed.

Pursuant to RCW 9.46.110 as the same now exists or may hereafter be amended, there is levied upon all persons, associations or organizations a tax on all gambling activities occurring within the city as permitted by state law at the following rates:

... [A- C unchanged]

D. All social card game rooms licensed under the provisions of RCW 9.46.030(1) and (4) at a rate equal to 10 ~~11~~ percent of the annual gross receipts exceeding \$10,000.

Section 2. Amendment in effect after September 30, 2005. Shoreline Municipal Code section 3.30.020 is amended as follows effective October 1, 2005:

3.31.020 Imposed.

Pursuant to RCW 9.46.110 as the same now exists or may hereafter be amended, there is levied upon all persons, associations or organizations a tax on all gambling activities occurring within the city as permitted by state law at the following rates:

... [A- C unchanged]

D. All social card game rooms licensed under the provisions of RCW 9.46.030(1) and (4) at a rate equal to ~~10~~ 11 percent of the annual gross receipts exceeding \$10,000.

Section 3. Sunset. The amendment implemented by Section 1 of this ordinance shall terminate, and the amendment restoring the gambling tax to 11% implemented by Section 2 of this ordinance shall take effect, on June 30, 2005, should the State Legislature pass Senate Bill 5287 or any bill which limits the authority of the city of Shoreline to tax social card rooms licensed under chapter 9.46. RCW to ten (10) percent or less, or allows a credit for Shoreline gambling taxes paid against a new state gambling tax levied by such bill against social card rooms licensed under chapter 9.46. RCW.

Section 4. Publication , Effective Date. A summary of this ordinance consisting of its title shall be published in the official newspaper of the City. This ordinance shall take effect and be in full force from April 1, 2005.

PASSED BY THE CITY COUNCIL ON MARCH 7, 2005.

Mayor Ronald B. Hansen

ATTEST:

APPROVED AS TO FORM:

Sharon Mattioli
City Clerk

Ian Sievers
City Attorney

Date of Publication: March 3, 2005

Effective Date: April 1, 2005

DISCLOSURE REQUIREMENTS

DEFINITION OF A RELATED PARTY

48.500 A related party is an entity that can control or significantly influence the management or operating policies of another entity to the extent one of the entities may be prevented from pursuing its own interests. A related party may be any party the entity deals with that can exercise that control. Examples of related parties include (a) affiliates, (b) investments accounted for under the equity method, (c) trusts for the benefit of employees (for example, pension or profit-sharing trusts), and (d) principal owners and members of management and their immediate families. (SFAS 57, par. 24)

48.501 Transactions between related parties should be recorded in the same manner as transactions between unrelated parties. That is, their substance, rather than their form, generally should govern the accounting. The following are examples of common related party transactions: (SFAS 57, par. 1)

- Sales, purchases, and transfers of property
- Services provided or received
- Property and equipment leases
- Loans or guarantees
- Maintenance of compensating bank balances for the benefit of a related party
- Allocations of common costs
- Filing consolidated tax returns

Common related party transactions include (a) officer or stockholder loans to or from the company, (b) purchases and sales among affiliated companies, (c) leases between stockholders and the company, and (d) guarantees or pledged personal assets of a stockholder.

Practical Consideration. A related party relationship does not exist simply because a company is economically dependent on another party (for example, a sole or major customer, supplier, franchisor, or distributor).

Guarantees between parents and their subsidiaries and corporations under common control, including a parent's guarantee of its subsidiary's debt to a third party or a subsidiary's guarantee of its parent's or another subsidiary's debt to a third party, are not subject to the recognition and measurement provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, but are subject to its disclosure requirements. Chapter 10 discusses accounting for and disclosing guarantees in further detail.

DISCLOSURES

48.502 The following information about material related party transactions (other than compensation arrangements, expense allowances, and similar items occurring in the normal course of business) should be disclosed: (The disclosures apply to the separate financial statements of each combined or consolidated entity as well as to the combined or consolidated financial statements. However, separate financial statements that are presented with the combined or consolidated financial statements need not duplicate the disclosures. Also,

consolidated or combined financial statements need not disclose related party transactions that were eliminated in consolidation or combination.)

a. Nature of the relationship involved (If necessary to an understanding of the relationship, the name of the related party also should be disclosed.)

b. Description of the transactions, including those for which no or nominal amounts were recorded, for each period for which an income statement is presented (The disclosure should include any other information necessary to understand the transactions' financial statement effects.)

c. Dollar amounts of the transactions for each period for which an income statement is presented (The disclosure also should include the effects of any change in terms from the terms used in the prior period.)

d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement (SFAS 57, par. 2) (Receivables from officers, employees, or affiliates should be shown separately rather than presented under a general heading such as notes receivable or accounts receivable.) (ARB 43, Ch. 1A, par. 5)

Practical Consideration. Disclosure of the relationship and amounts often may be conveniently provided through balance sheet captions. The authors generally interpret "nature of the relationship" to mean position rather than an individual's name. Accordingly, captions usually may refer to "stockholders," "officers," or "affiliates." A related party may need to be identified by name, however, if that is necessary to understand the effects of the transaction on the financial statements.

e. For an entity that is part of a group that files a consolidated tax return, the following in its separately issued financial statements: (SFAS 109, par. 49)

(1) Aggregate amount of current and deferred tax expense for each income statement presented

(2) Amount of any tax-related balances due to or from affiliates as of the date of each balance sheet presented

(3) Principal provisions of the method by which the consolidated amount of current and deferred tax expense is allocated to members of the group

(4) Nature and effect of any changes in the method of allocating current and deferred tax expense to members of the group and in determining the related balances due to or from affiliates during each year for which the disclosures in a. and b. are presented

If results of operations or financial position could change significantly as a result of common ownership or management control of the reporting entity and other entities, the nature of the ownership or management control also should be disclosed, even if there are no transactions between the entities. (SFAS 57, par. 4)

Practical Consideration. Authoritative literature does not require economic dependence to be disclosed. However, SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, does require concentrations in the volume of business transacted with particular customers to be disclosed if loss of the relationship could cause a severe impact to the company. (Chapter 10.)

48.503 Because related party transactions cannot be presumed to be conducted under competitive, free-market conditions, the preceding disclosures should not imply that the transactions were made on an arm's-length basis unless that representation can be substantiated. (SFAS 57, par. 3)

Practical Consideration. Thus, for example, if a company represents in its financial statements that transactions with a related party were consummated on terms no less favorable than would have been obtained from an unrelated party, accountants must be satisfied that such a representation is appropriate. If management is unable to substantiate that representation, accountants reporting on the company's financial statements are required to modify their report for a departure from GAAP.

48.504 In addition to the disclosures in the preceding paragraphs, guarantees between related parties are subject to the disclosure requirements of FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. See Chapter 10. (FASBI 45, par. 16)

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