



BRIEFLY

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Gambling on Tax Relief

Initiative 892 would allow non-tribal gambling establishments to deploy electronic gaming machines. The state would tax the net winnings from these machines and earmark the revenues to lower property taxes. Proponents say that the machines will reduce the state property tax rate (currently \$2.60 per \$1,000 of actual market value) by 27 percent and allow a more level playing field in the competition between tribal and non-tribal casinos. Opponents argue that the state's tax take from the machines and property tax reduction will be much lower and that the expansion of gaming opportunities will have high social costs.

The machines that the initiative authorizes are already in play at Washington's tribal casinos. Although arguably these tribal machines look and play like the slot machines found in Nevada casinos, by construction they are electronic scratch ticket machines rather than true slot machines. This arcane technical distinction provides the loophole that allows the tribes to offer machine gaming in spite of a state law that strictly prohibits slots.

Tribal Slots

For much of Washington's history, the state constitution prohibited nearly all forms of gambling other than bets on horse races. The door to a substantial expansion of gambling opened in 1972 when voters approved a constitutional amendment removing the prohibition against lotteries (broadly interpreted as any game of chance). Within a decade the legislature had authorized cardrooms, "commercial stimulants" such as punchboards and pulltabs, charitable "Reno nights," sports pools, and the state lottery.

The biggest expansion in gaming, however, began with the opening of the Tulalip Casino in 1992.

Under longstanding principles of federal law, states can enforce their criminal laws on tribal lands, but not their regulatory laws. In 1987, the U.S. Supreme court extended those principles to Indian gaming in the landmark case, *California v. Cabazon Band of Mission Indians*. In *Cabazon* the court ruled that when a state strictly prohibits a form of gambling activity, that prohibition is a part of its criminal law and enforceable on tribal lands. When, on the other hand, a state allows a gambling activity, but places limits on its operations, those limits are interpreted to be part of the state's regulatory law. Tribes can offer the activity without the state-imposed limitations. Thus, for example, if a state allows occasional low-stakes charitable bingo games, tribes can operate large-scale, high-stakes bingo parlors.

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In 1988, following *Cabazon*, Congress passed the Indian Gaming Regulatory Act (IGRA), to establish a federal legal framework that acknowledged both the court recognized rights of the tribes and the competing interests of the states. Under IGRA, tribal casinos are to be regulated through tribal-state compacts, which states are required to negotiate in “good faith.” States may not tax either tribal gaming activity itself or associated purchases of equipment or services by tribal gaming enterprises. To date, Washington State has signed compacts with 27 tribes. Twenty-two casinos currently operate under compacts. The compacts generally require the tribes to pay modest impact mitigation fees to local governments, generally from 1 to 2 percent of the net winnings. (In contrast, non-tribal establishments pay local gambling taxes at rates of up to 20 percent, as well as the usual range of state and local taxes on business.)

Under the terms of *Cabazon*, Washington cannot prohibit tribes from operating games that state law allows charities to operate at fund-raising “Reno nights.” Through this loophole, tribal casinos offering keno and table games like blackjack, poker, craps and roulette entered the state. Tribal casinos cannot offer true slot machines, however, because these machines are strictly prohibited by state law.

While initially tribal casinos offered no machine gaming, in 1998 they began to introduce electronic scratch ticket machines that have the look and feel of slots.

With the traditional mechanical slot machine, a player inserts a coin and pulls forward an arm. This sets in motion a series of tumblers that determine whether and how much the machine will pay out on that play. On newer machines, debit cards replace the coins and the guts are electronic rather than mechanical, with the tumblers replaced by a random number generator that determines whether the player wins or loses at the time she plays the machine.

In contrast to electronic slots, electronic scratch ticket machines are terminals connected to a central computer; the memory of this central terminal holds a stack of virtual scratch ticket tickets. Each time a player plays one of the electronic scratch ticket machines, a ticket is transmitted to that machine from the central computer. Whether that ticket is a winner or a loser is determined before the player plays.

Because Washington has a state lottery that offers scratch ticket games, *Cabazon* says the state cannot prohibit tribal scratch ticket machines. Under IGRA, the number of these machines and the specifics their operation must be negotiated in the compacts between the tribes and the state. These compacts set the current 18,225 limit on the number of tribal machines.

Electronic scratch ticket machines for non-tribal enterprises

I-892 would allow non-tribal businesses to offer the same gaming machines that tribal casinos offer.

Non-tribal enterprises like bowling alleys, taverns, cardrooms and horse tracks that are currently licensed to offer gambling by either the state Gambling Commission or the Horse Racing Commission will be eligible for electronic scratch ticket machines. (Convenience stores or

other businesses that are easily accessible to minors, however, will not be eligible.) The Lottery Commission would then issue electronic scratch ticket licenses to those organizations that have possessed valid gaming licenses for at least 6 months.

Electronic scratch ticket licensees will be limited to the same type and number of electronic scratch machines that the tribal casinos are authorized to operate. (There are 18,225 tribal machines currently authorized.) The machines are allocated to establishments based upon the category they operate in:

- Fifteen percent of machines go to the top 40 charitable or non-profit groups licensed by the gambling commission, ranked by gaming gross receipts. (Each organization can operate at most 125 machines.)
- Thirty-six percent of machines go to house-banked card rooms with five or more tables and to horse racing facilities. (Each establishment can operate 125 machines maximum.)
- Forty-nine percent of machines go to other gambling commission licensees: taverns, restaurants, bowling alleys, bingo parlors, charities, and not-for-profits. (There is a cap on the number of machines allowed per establishment that varies with gambling gross receipts.)

In the initial allocation, the Lottery Commission will give each of the top 40 charitable or non-profit groups the same number of machines. Similarly, the Commission will give each eligible cardroom the same number of machines. Within the third group, the Commission will allocate machines in proportion to gambling gross receipts, but with each establishment guaranteed at least four machines. These allocations are permanent. In each subsequent year, to the extent that machines are available because they were not previously allocated, because existing licensees have forfeited machines, or because the number of tribal machines has increased, the Lottery Commission will allocate these additional machines within the groups.

Since the right to offer machines will be attached to the license to conduct another form of gaming activity, local governments will not be able to decide separately whether to allow establishments to offer electronic scratch ticket machines within their jurisdictions. Banning the machines will require banning the other gaming activities, bingo or cardrooms for example, as well.

According to the summary of I-892 issued by the Senate Ways and Means Committee, the Lottery Commission expects that 500 terminals will be in place by January 2006. By July 2006, the number of machines increase to 13,100, and the full 18,225 machines will be in place by January 2007.

Fiscal Impact:

Establishment owners will retain 65 percent of the net winnings from the machines. (The net winnings are the difference between the amount

put into the machines by players and the amount paid out in prizes. The initiative requires that the machines pay out at least 75 percent of receipts as prizes. The industry norm appears to be to pay out about 90 percent.) From the 65 percent they retain, owners will pay the costs of buying or leasing the machines. The state collects the remaining 35 percent of net winnings. After administrative costs, 99 percent of the state collection is deposited into the Equal Treatment Equals Lower Property Taxes Account. Each year state property tax levies will be reduced by the prior year's deposit into the property tax account. The remaining 1 percent of the state's share of the net winnings funds problem-gambling programs.

Proponents assume that the machines will bring in \$175 net profit per day, on average, and forecast net deposits into the property taxes account of \$400 million per year.

Dallas Burnett of the state Gambling Commission is quoted in the Seattle Times estimating the average net profit at \$115 per day. This would lead to approximately \$267 million a year to be used for property tax relief.

The financial impact estimate prepared by OFM states that potentially I-892's net deposits into the property taxes account are (based on \$112/day net winnings):

- In calendar year 2006: \$90,577,000
- In calendar year 2007: \$234,121,000
- In calendar years 2008-2011: \$251,985,000/year

OFM estimates that in 2007, the reduction in property tax is approximately \$13 per \$100,000 of property value. In 2009, the reduction will rise to approximately \$32 per \$100,000. For a \$224,000 house, the statewide median value in the spring of 2004, the tax reduction would be about \$70.

Competition will increase as the electronic scratch machines are implemented, which could affect revenues of other games:

- OFM believes that electronic scratch machines could have an adverse affect on lottery sales. If Lottery Commission product sales fall by 25 percent, lottery revenue deposited into the Education Construction Account could decrease by \$19.3 million in the 2005-2007 biennium; and decrease by \$60 million in the 2007-2009 biennium.
- The state Gambling Commission forecasts a decrease in revenue from pull-tab, punchboard, bingo, and card games; local gambling revenues could decrease by \$7.5 million in 2007, and \$8.4 million in 2008 and in 2009.

Discussion

Evaluation of I-892 involves consideration of three issues: property tax relief, gambling expansion, and competitive neutrality.

The property tax relief provided by the initiative will likely fall somewhere in the range bounded by the proponents' optimistic \$400 million

and the conservative \$267 million. Some of the machines will be placed in venues where they are unlikely to have the heavy use they would receive in casinos; the payback will vary among venues, with some surely paying more than the 75 percent required by the initiative; and the doubling of machines may dilute the market somewhat. Regardless, the proposal guarantees some measure of property tax relief without reducing governmental revenues, other than the incidental effects on lottery sales, pulltabs, and bingo.

While the magnitude of the property tax relief cannot be forecast with any certainty, the expansion in gambling opportunities is clear. If I-892 passes, there will be 18,225 new slot-like machines distributed throughout the state according to the carefully crafted formula in the initiative. There's nothing to suggest that there will not be takers for the new equipment. For those opposed to any expansion in gambling, that's enough to justify opposition. Supporters of the initiative note that tribal gambling has already changed the landscape dramatically. This expansion won't alter the state's social fabric or impose new social costs, they contend.

The third factor, competitive neutrality, refers to the proponents' "Just Treat Us the Same" theme. A lucrative source of revenue, these slot-like devices are available to tribal businesses, but not to their non-tribal competitors. That places those competitors at a disadvantage, a disadvantage resulting from a public policy decision made by legislators not to let these establishments offer the same games as others. Of course, should I-892 become law, new non-tribal entrants into the market will still be at a competitive disadvantage because the slots authorized by the initiative will already have been fully allocated.

The relative weight of these factors will likely determine I-892's fate in November.

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