

HOT TOPICS IN CASINO TAXATION FOR 2009

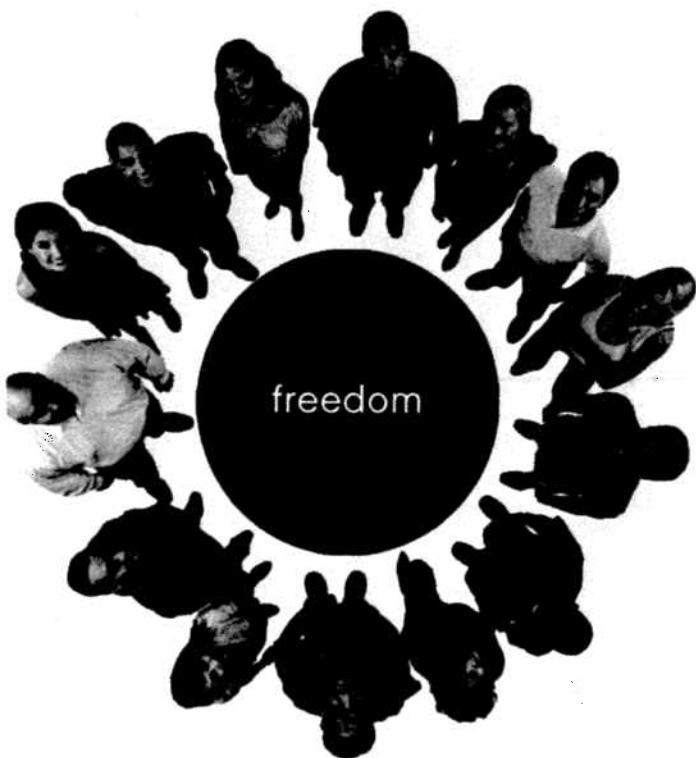
By Peter J. Kulick

2009

will be a historic year in the United States. On Jan. 20, 2009, Barack Obama will be sworn in as the first U.S. President of African-American descent. President-elect Obama's swearing-in will usher in a new administration faced with challenging economic circumstances. The new administration will have to contend with the dramatic economic events of 2008, which have spiraled the world economy into a recession. "Change" was the *nom du jour* during the 2008 election cycle. And the notion of "change" will continue to be a predominant force shaping legislative policy during 2009, especially with respect to tax policy.

Recent financial data reveals a decline in gaming revenue in most U.S. jurisdictions with commercial gaming. This drop in gaming revenue has the consequence of reducing state and local tax revenue. Federal, state and local governments are not immune to the effects of the recession. Governmental units, just like their counterparts in the private sector, are bracing for sharp declines in revenue. As a result, all levels of government will likely focus their attention on alternative methods to replace lost tax revenue.

There are several significant tax policy issues with a direct impact on the casino industry that are likely to be the subject of



intense debate in 2009. The list of tax issues encompasses both federal and state policies. The prospective changes range from rate hikes to increased enforcement activity. Casinos and other gaming businesses must stay vigilant in order to minimize the impact of tax law changes.

citizens. UIGEA restricts the use of "payment systems" by U.S. citizens to place online wagers. UIGEA functions by subjecting certain payment system participants, including financial institutions, to the act and, further, requires financial institutions to develop "policies and procedures reasonably designed to identify

■ What can the gaming industry expect in the event Congress authorizes Internet gambling? ■

Developments in Federal Law

Federal tax laws are expected to receive early attention from the Obama administration. Congress and the new administration are already floating the prospect of a new federal bailout package. The new bailout could contain several beneficial tax law changes, such as accelerating cost-recovery deductions, extending tax credits, and creating new tax credits and deductions. Like any U.S. taxpayer, casinos and other gaming businesses will undoubtedly be impacted by any change in the federal tax laws. Other tax policy initiatives that uniquely apply to the gaming industry may also be the subject of congressional action in 2009. Two such initiatives that will impact the gaming industry are: 1) Internet gambling; and 2) expanding the government bailout programs.

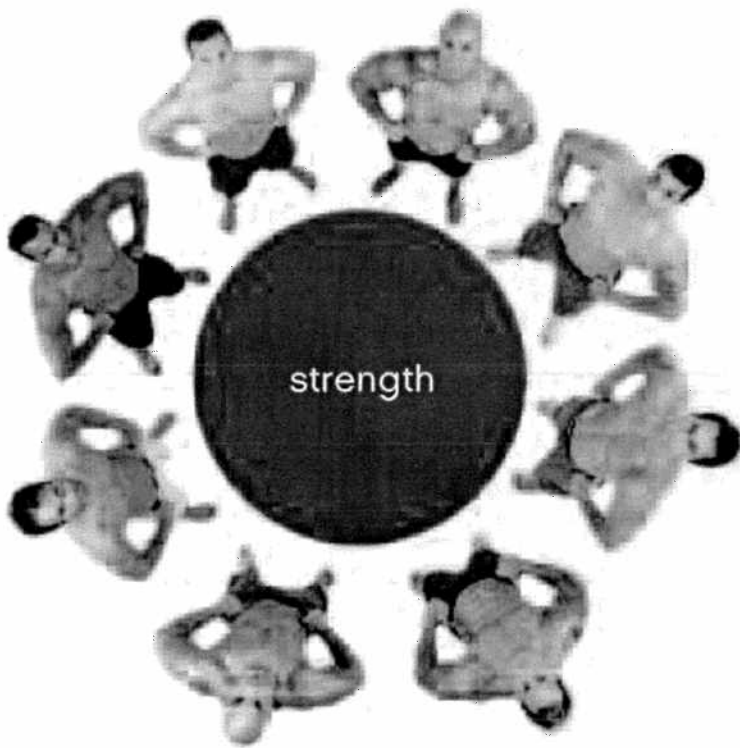
Internet Gambling Legislation

Internet gambling has been a popular topic over the past several years. Many foreign nations have sanctioned Internet gambling. The Internet gambling market represents a growing segment of the gaming market. In the United States, the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) was enacted, ostensibly, to enforce the prohibition of Internet gambling by U.S.

and block or otherwise prevent or prohibit restricted transactions." On Nov. 12, 2008, the Department of Treasury and the Federal Reserve jointly released controversial final rules implementing provisions of UIGEA. UIGEA has been the subject of intense criticism by online gambling advocates and financial institutions.

Congressman Barney Frank (D-Mass.), chairman of the House Committee on Financial Service, has consistently questioned the desirability and scope of UIGEA and the underlying regulations. The increased Democrat majorities in Congress, coupled with a new administration, raise the potential that UIGEA and the U.S. ban on Internet gambling will be reconsidered. First, it is expected that Congress will seek to legislatively repeal the final rules recently promulgated under UIGEA and/or greatly modify the legal architecture of UIGEA. Second, there may be a push in the 111th Congress to authorize some form of Internet gambling. The growing federal budget deficit and the potential revenue stream that could be generated from an excise tax on Internet gambling may offer sufficient political cover and incentive for Congress.

What can the gaming industry expect if Congress authorizes Internet gambling? In all likelihood, Congress would impose a



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federal excise tax on Internet wagers. The new source of revenue could also offer a political response to critics of future government bailout packages. Furthermore, if the legislation introduced by Frank is any indication of the future of Internet gambling, any form of online gambling would exclude sports betting. Frank introduced legislation in the 110th Congress to soften the reach of UIGEA by limiting the prohibited gambling activity to sports betting.

Extending Federal Bailout Programs

In early October 2008, Congress passed the first federal bailout program by enacting the Emergency Economic Stabilization Act of 2008. As the U.S. economic situation worsens, the prospect increases that Congress will pass more economic stimulus programs. At CEM's press time, the domestic automotive industry was pushing for a \$15 billion federal emergency loan program. Congressional leaders have floated the notion of passing an additional \$500 billion economic stimulus program when the 111th Congress convenes in early January 2009.

Overlooked components of the Emergency Economic Stabilization Act of 2008, and likely components of future federal economic stimulus packages, are the beneficial tax law changes for businesses. Tax provisions in the Emergency Economic Stabilization Act of 2008 that may be beneficial to gaming industry businesses include:

- Extension of the research credit through 2009. The extension of the research credit may be of particular interest to those gaming businesses involved in the development of new gaming equipment and devices.
- Fifty percent bonus depreciation for "qualified reuse and recycling property" that is placed in service after Aug. 31,

2008. The bonus depreciation for qualified reuse and recycling property is not limited to businesses in the recycling industry.

- Extension of the 15-year amortization period for leasehold improvements and certain other building improvements to qualifying retail and restaurant properties.

It is likely that any future economic stimulus program enacted by Congress will include further tax law changes. Future tax law changes, that may be particularly beneficial to gaming businesses, could include enhancing cost recovery write-offs and further extending business tax credits. In addition to tax law changes, a potential indirect benefit of economic stimulus programs includes the easing of lending markets, which in turn may make capital available to finance current projects and lead to increased consumer spending.

Specific State Tax Law Changes

Beginning in 2008, many states began to experience budget shortfalls due to declining tax revenue. The revenue shortfall trend is expected to continue and widen during 2009. Increasing taxes on gaming is an easy target for state legislatures that are trying to eliminate revenue shortfalls. As a result, there is significant risk that state legislatures could turn to the gaming industry to fund budget shortfalls arising in the current economic climate.

Gaming industry payments to state and local governments embrace a range of taxes, fees and charges. Common gaming-related payments include wagering taxes, licensing fees, casino admission fees and taxes, and hotel room and entertainment taxes. In addition, casinos and gaming businesses are also subject to traditional forms of state taxation, such as business activity taxes, sales taxes and property taxes. Consequently, an increase in gaming-related taxes could take any one or combination of the following forms:

- Increased wagering tax rates
- Increased hotel room and/or entertainment tax rates
- Larger licensing fees
- Increased rates of other business taxes, such as property taxes, sales taxes or other business activity taxes
- Greater enforcement activity of existing tax laws

In most U.S. jurisdictions, gaming-related taxes comprise a relatively small portion of total state tax revenue. The probability of raising taxes on casinos is questionable, particularly as a revenue generator. For instance, economists have found that raising revenue on gaming activities is undesirable because it is typically an inefficient revenue source and too expensive to properly administer. Moreover, it can be argued that increasing tax rates results in a lower handle, which would, in turn, result in a decrease in tax revenue. Therefore, from a general tax policy perspective, pinning the hopes of a return to fiscal normalcy on increased gaming taxes is a long shot.

State Specific Tax Changes and Concerns

A combination of 2008 ballot initiatives and potential tax law changes highlight state tax issues on the horizon for the gaming industry. Following are comments on select state law changes and concerns.



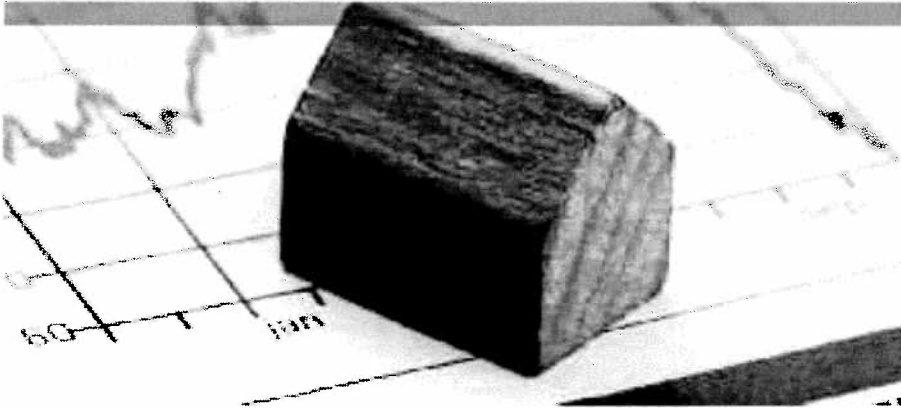
Nevada Hotel Room Tax Increase

Voters in Clark County, Nev., approved a measure on the 2008 ballot to increase the hotel room tax by 3 percent, raising the tax rate to 13 percent. The funds generated from the increased tax rate are dedicated to educational programs and raising teacher salaries. The impact of the increased tax on hotel room rates and tourism is unknown, although the ballot initiative was not actively opposed by most hotel operators.

Missouri Voters Approve 1 Percent Increase

Missouri voters approved a ballot initiative that resulted in a 1 percent increase in the state's wagering tax. The Missouri ballot proposal also limited future expansion of casinos. Thus, the increase in the wagering tax did not face opposition from currently operating Missouri casinos.

■ In a climate of falling real estate property values, the time may be ripe to challenge property tax assessments. ■



Possible Maine Lodging Tax Increase

Analysts have warned that the Maine legislature may increase the excise taxes on meals and lodging. The tax rate increase is likely to have minimal impact on Maine's small gaming industry.

New Jersey Scrutiny of Expenditures

The downturn in gaming revenue for New Jersey casinos during 2007 and 2008 has resulted in corresponding declines in the New Jersey Casino Revenue Fund. Gaming revenue in New Jersey declined by 5.7 percent in 2007 and dropped by 6.3 percent through September 2008. This has resulted in an approximate \$100 million decline in the balance of the state's Casino Revenue Fund. New Jersey state legislators have publicly called for greater state oversight of casino tax revenue. As a result, there should be concern that New Jersey regulators may more closely examine wagering tax receipts and increased enforcement activity. Increase enforcement activity could lead to a greater number of audits or efforts to expand the scope of casino-derived income included within the tax base of the New Jersey wagering tax.

General Increases in Enforcement Activities

Casinos and other gaming businesses should also be concerned about increased tax enforcement activity by the states. Enforcement activity can take several different forms. First, gaming suppliers must be aware that states may seek to impose business taxes in connection with indirect business activities of suppliers with casino properties located in the taxing jurisdiction. For instance, an equipment supplier supplying devices to a casino property in Nevada could be susceptible to efforts by another state to impose business taxes on the suppliers if the casino also has a property situated in the other state, even if the supplier does not directly supply equipment to the property in the other state. Second, casinos should carefully review property tax assessments. In a climate of falling real estate property values, the time may be ripe to challenge property tax assessments. Third, states that impose personal property taxes may seek to expand the types of personal property subject to taxation.

Final Comments

The combination of a new political landscape and a worsening economic climate in 2009 is likely to be a strong shaper of tax laws applicable to the casino industry. The new administration, coupled with increased Democratic majorities in Congress, raises the prospect that restrictions on Internet gambling will be significantly curtailed or altogether eliminated. The authorization of some form of Internet gambling could very well result in a new excise tax on Internet gambling activity. Expansion of economic stimulus programs could also lead to favorable modifications in federal tax law, including the enhancement of existing business tax credits and deductions, and/or the acceleration of existing cost recovery allowances.

In addition to changes at the federal level, the casino industry is likely to face several state tax law changes. The gaming industry must guard against the prospect of increased tax rates and licensing fees. Furthermore, in a time of state budget shortfalls, state governments may turn to greater enforcement activity as a means to raise or replace lost revenue. Consequently, casinos and other gaming businesses should be in a position to quickly respond to increased audits or other measures to expand tax bases.



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