

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2011

Legislative Fiscal Note

BILL NUMBER: House Bill 1180 (First Edition)

SHORT TITLE: Video Sweepstakes Entertainment Tax.

SPONSOR(S): Representatives Owens, McGee, Spear, and Collins

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	<u>FY 2012-13</u>	<u>FY 2013-14</u>	<u>FY 2014-15</u>	<u>FY 2015-16</u>	<u>FY 2016-17</u>
REVENUES					
General Fund	*\$98 million - \$329 million per fiscal year; \$225 million expected annual yield*				
Local Government	*50 municipalities will experience a net revenue loss, all counties will gain revenue*				
EXPENDITURES					
Education (94% of Revenue)	*\$92.5 million - \$310 million annually*				
Law Enforcement (6% of Revenue)	*\$5.9 million - \$310 million annually*				
POSITIONS (cumulative):					
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue, Local Law Enforcement and NC Sherriff's Association					
EFFECTIVE DATE: Effective January 1, 2013					

BILL SUMMARY: HB 1180 enacts Article 2E, Video Sweepstakes Entertainment Tax, imposing a licensing requirement and tax on video sweepstakes establishments, an excise tax on each video sweepstakes machine or device, and a tax on gross receipts. The legislation requires a person operating a video sweepstakes establishment to pay an annual license tax of \$2,000 for the privilege of operating the establishment and a \$1,000 per machine fee. Video sweepstakes operators must remit 4% of taxable gross receipts, as defined, from operating a video sweepstakes machine or device.

HB 1180 sets out the requirements for license applicants and authorizes the Secretary of Revenue (Secretary) to deny issuance of a license for any of the detailed reasons. The Secretary may cancel a license under certain circumstances and requires notice and an opportunity for a hearing when a license is summarily cancelled. HB 1180 also requires applicants to file a bond or an irrevocable letter of credit.

The local privilege license tax for video sweepstakes operators is capped at \$1,000 on each video sweepstake establishment and may be levied by either the cities or the counties. In addition to the annual per establishment license tax of \$1,000, counties and cities may impose an annual excise tax of \$500 per machine. This revenue is local revenue and not a state expenditure.

Revenue Distribution under HB 1180:

1. Up to 6% of the tax proceeds from the license tax and the excise tax to be distributed to local law enforcement agencies on the following schedule:
 - (1) 4% to county sheriff's departments on a per capita basis and
 - (2) 2% collected from video sweepstakes establishments to city police departments on a per capita basis.
2. Requires the remaining tax proceeds to be credited to the General Fund and appropriated for public education.

ASSUMPTIONS AND METHODOLOGY: If enacted, Fiscal Research estimates that HB 1180 will generate between \$98 million and \$329 million in General Fund revenue per fiscal year. It is important to note that the amount of revenue generated by HB 1180 is highly dependent on how sweepstakes gaming is taxed and regulated. It is expected that HB 1180, under the existing proposal, will generate \$106 million in the first fiscal year and \$225 million in subsequent years.

According to a Maryland Department of Legislative Services report on video lottery terminals, the key determinant in forecasting the revenue generated by legalizing video lottery is the win-per-day amount.¹ Maryland researchers define win-per-day as the net/taxable receipts generated per VLT. VLTs generate more net revenue per machine, according to researchers, if the terminals are located areas with fewer competing gambling interests and more populous areas.

The Office of State Budget and Management (OSBM) and the Governor's Office estimate that a \$1,000 tax per video sweepstakes machine, coupled with a \$2,000 tax per internet sweepstakes café, and a 4% receipts tax will generate between \$300 million in the first fiscal year and up to \$500 million in subsequent years.^{2,3} As shown in Table 1, the Governor's proposal does not clarify whether total receipts or receipts net winnings are subject to the 4% receipts tax. HB 1180 defines taxable gross receipts as the receipts received from operating sweepstakes machines or devices less the amount of any prizes transferred to sweepstakes entrants. Table 1 below provides more detail on revenue collections under the Governor's Video Sweepstakes Entertainment Tax proposal.

¹ Maryland Department of Legislative Services, Office of Policy Analysis, "Legislators' Guide to Video Lottery Terminal Gambling," January 2004, http://mlis.state.md.us/other/Fiscal_Briefings_and_Reports/00_Leg%20Guide%20to%20VLT%20Gambling.pdf, (accessed March 16, 2010).

²"State of North Carolina, Office of Governor Beverly Perdue, "Governor Purdue Proposes Funding to Protect Schools," Published June 7, 2012, Available at: <http://www.governor.state.nc.us/NewsItems/PressReleaseDetail.aspx?newsItemID=2455>.

³ Email correspondence with Governor's Office, May 22, 2012.

Table 1. *Governor's Proposal					
	Taxable Receipts	Tax Revenue	Per Machine Fee Revenue	Per Café Fee Revenue	Taxable Receipts
*Assumptions	100% of Total Receipts	Tax Revenue (4% of Total Receipts)	\$1,000 per terminal (80K terminals)	\$2,000 per Café	TOTAL REVENUE
Revenue	\$5.2 B	\$208 M	\$80 M	\$160 M	\$448 M
*Calculations of the Governor's revenue estimates have not been released. These assumptions are based on information shared via email correspondence.					

Fiscal Research estimates are based on the State containing between 60,000 and 169,000 internet sweepstakes terminals. The upper bound of 169,000 terminals estimate is high, but comparable to the population to internet sweepstakes terminal ratios found in Montana and South Dakota. Both states are sparsely populated, but have very few regulations associated with this type of gaming.

The lower bound estimate of 60,000 internet sweepstakes terminal is also comparable to the per capita machine numbers experienced in South Carolina during the states' brief period of legalized video poker. South Carolina's Supreme Court ruled on November 19, 1998 that video poker was legal in the state.⁴ According to *The Charlotte Observer*, the number of video poker terminals operating in South Carolina doubled-between 1991 and 1999 from 15,000 machines to 30,000 machines with gambler's annual expenditures exceeding \$2.3 billion in 1999.⁵

As shown in Table 2, South Carolina residents expended an estimated \$2.3 billion per year on video poker in 1999. This equals roughly \$76,667 per machine in total revenue. Information from the Governor's office suggests that each sweepstakes terminal generates between \$12,000 and \$60,000 annually. If North Carolina residents expend the same amount of money spent in South Carolina during the late 90's, total internet sweepstakes spending would equal between \$4.6 billion and \$13.0 billion in total sales.

⁴ Dube, Jonathan. "Gambling Given S.C. Courts Blessing," *The Charlotte Observer*, Published November 19, 1998, <http://www.jondube.com/resume/charlotte/vpruling.html>, (accessed December 1, 2010).

⁵ Ibid.

Table 2. Assumptions used in Revenue Estimate of HB 1180					
	# of Terminals*	#Sweepstake Cafés	Population per Terminal	Total Receipts*	Total Receipts per Machine
South Carolina c. 1999	30,000	-	134	2,300,000,000	\$76,667
HB 1180 Assumptions for North Carolina					
	# of Terminals	#Sweepstake Cafés	Population per Terminal	Total Receipts**	Total Receipts per Machine
Low	60,000	800	161	4,600,000,000	-
High	169,411	2,259	57	12,988,141,696	-
*Information based on November 1998 <i>The Charlotte Observer</i> article					
** NC Total Receipts assumes each internet terminal collects \$76,667 in total receipts similar to the receipts generated in SC during the late 90's.					

Though total internet sweepstakes receipts/sales are estimated at \$4.6 billion to \$13.0 billion annually, customers will retain 80% to 70% of total spending. According to the *Business Week* article, “The Casino Next Door,” the average payout for an internet sweepstakes contest is 90%.⁶ This means that for every dollar a consumer spends the player is likely to win 90-cents of the expended dollar back. Consumers are likely to play numerous times, thus decreasing total winnings by an average of 10% each time the game is played. HB 1180 defines the 20% to 30% of total spending retained by retailers as gross receipts and thus taxable. Under HB 1180, internet sweepstakes will generate \$920 million to \$3.9 billion in taxable collections. The proposed 4% tax on gross (taxable) receipts will generate between \$36.8 million and \$155.9 million in General Fund revenue. Table 3 provides more detail.

In addition to the 4% gross receipts tax, HB 1180 applies annual fees of \$1,000 per internet sweepstakes terminal and \$2,000 per sweepstakes café. Fiscal Research estimates that 60,000 to 70,000 sweepstakes terminals currently operate in NC and that number could grow if HB 1180 were enacted. Per terminal and per sweepstakes café fees combined with the gross receipts tax would generate between \$98.4 million and \$329.8 million in annual General Fund revenue (detailed in Table 3). The proposal allocates 94% of annual collections to education and the remaining 6% to law enforcement.

⁶Gillette, Felix. “The Casino Next Door,” *Business Week*, Published April 21, 2011. Available at: http://www.businessweek.com/magazine/content/11_18/b4226076180073.htm (accessed June 2012).

Table 3. Revenue from Implementing Video Sweepstakes Entertainment Tax, Per Fiscal Year					
	Taxable Receipts	Tax Revenue	Per Machine Fee Revenue	Per Café Fee Revenue	
HB 1180	20%-30% of Total Receipts	4% of Taxable Receipts	\$1,000 per machine	\$2,000 per Café	TOTAL REVENUE
Low	\$ 920 M	\$ 36.8 M	\$ 60 M	\$1.6 M	\$ 98 M
High	\$ 3.9 B	\$ 155 M	\$ 169.4 M	\$4.5 M	\$ 329 M
Taxable Receipts equals Total Receipts less prize payouts. Most machines have a 90% winnings payout ratio. On average 20% to 30% of the total money the consumer spends is retained by the sweepstakes operator.					

SOURCES OF DATA: Various sources, as cited.

TECHNICAL CONSIDERATIONS: None

FISCAL RESEARCH DIVISION: (919) 733-4910

PREPARED BY: Sandra Johnson

APPROVED BY: Mark Trogon, Acting Director
Fiscal Research Division

DATE: June 26, 2012



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