



August 2004

## **Summary of Initiative 892 to the People** (Authorizing Electronic Scratch Tickets for State Property Tax Reduction)

**This information has been prepared in response to various requests for a summary of the provisions of Initiative 892, which will be before the voters at the statewide general election on November 2, 2004. The material in this summary is provided for informational purposes only. It is provided for use by members of the Legislature and legislative staff. It is not provided as an expression for or against any of the provisions of Initiative 892. Additionally, the summary is prepared based on current revenue projections as of June 2004. However, this information is subject to change.**

**A copy of the initiative is available from the Secretary of State's Office directly or on the Web at: <http://www.secstate.wa.gov/elections/initiatives/text/i892.pdf>.**

### **Brief Summary**

If adopted, Initiative 892 would allow persons over the age of 21 to gamble at electronic scratch ticket terminals offered by certain entities and licensed by either the Washington State Gambling Commission (such as card-rooms, taverns, restaurants, bowling alleys, and non-profit bingo halls) or the Washington Horse Racing Commission. The State Lottery Commission would operate a centralized accounting and auditing computer system that monitors and records critical functions of player terminals. Separate computer systems, authorized and monitored by the Lottery Commission would create finite groups of game sets to be distributed electronically to electronic scratch ticket terminals at licensed facilities at the demand of players.

If Initiative 892 is adopted, a new state tax would be imposed on non-tribal gambling establishments equal to 35 percent of the net win from electronic scratch ticket machines. After deduction of state lottery administrative expenses, 99 percent of the revenues from the tax are to be used to reduce the state property tax levy starting in calendar year 2007, and 1 percent of the revenues from the tax is to be distributed to a nonprofit entity providing services necessary to address problem gambling.

### **Gambling Background**

In 1933, pari-mutuel betting on horse racing was authorized by statute and the Horse Racing Commission was established. The Washington State Constitution was amended in 1972 to prohibit gambling within the jurisdiction of the state unless approved by an affirmative vote of sixty percent of either the members of each house of the legislature or the voters in an election on an initiative or referendum.

The Washington State Gambling Commission was created in 1973. Forms of gambling currently statutorily authorized and regulated by the Gambling Commission include:

- Bingo, raffles, and "Reno nights" that support bona fide charities;
- Social card games, where participants bet against each other, and punch boards and pull-tabs; and
- Card games where participants bet against "the house" rather than against other players - these establishments are known as "enhanced card rooms" or mini-casinos.

In 1982, the State Lottery Commission (LC) was established. The LC currently offers, through private establishments, two styles of gambling: "scratch" tickets, and "on-line" games, such as Lotto, Quinto, and Mega Millions. After paying winners and deducting operating expenses, revenues raised by these games are dedicated to certain state funds, including education.

In 1988, the United States Congress enacted the Indian Gaming Regulatory Act, allowing federally recognized Tribes to offer any form of gambling authorized by the state in which the Tribe is located, subject to negotiation of a gaming compact with the state. During negotiations, the state and Tribes could not agree whether certain forms of "machine gaming" were legal. The question was submitted to a court, which ruled that while the state could not be required to allow "true" slot machines, the state and Tribes were required to negotiate regarding electronic gaming devices where (a) no cash or coin is inserted into or paid out of the machines; and (b) winning plays are not randomly determined by individual machines, but are instead based on a finite number of predetermined winning and losing electronic scratch tickets that are shared among at least two machines.

Currently, 19 Tribes operate casinos on tribal trust lands, in which card, dice and other games permitted under the statutes authorizing card rooms, Reno Nights and pari-mutuel horse racing, are offered, along with "electronic scratch ticket" machines or "video lottery terminals." Under the compacts, each Tribe may own 675 machines, or a total of 18,225 machines for the 27 Tribes that have reached agreements with the state. The Tribes may lease machines to each other, up to a limit of 2,000 machines per Tribe. Approximately 15,000 machines are currently in operation.

### **Gambling Summary**

The initiative empowers the LC to operate an electronic scratch ticket system which is similar to the systems currently offered by tribal casinos that have gaming compacts with the state. This electronic scratch ticket system includes a centralized auditing computer system maintained by the LC, as well as computers owned or leased by licensed operators, and approved by the LC, the latter of which generate finite sets of winning and losing "games sets" that are electronically distributed to a number of electronic scratch ticket terminals. The terminals do not accept or dispense cash. Rather, players play for "game play credits" which are convertible to cash as prizes paid by the licensee.

Under the Initiative, certain business entities licensed by the Gambling Commission or the Horse Racing Commission are eligible to receive a number of electronic scratch ticket terminals, although the total number cannot exceed the number of electronic scratch ticket machines allocated to all Tribes, and may be adjusted annually.

The initiative divides the Gambling and Horse Racing Commission-licensed entities eligible to offer electronic scratch ticket machines into three classes:

- (a) The forty largest charitable bingo operators.
- (b) House-banked card rooms (also known as mini-casinos) and any horse racing facility that has been in continuous operation for at least six months. (Currently there are approximately 80 house-banked card rooms, and one qualifying horse racing facility: Emerald Downs in Auburn).
- (c) Establishments primarily engaged in selling food or drink for on-premise consumption (such as restaurants, taverns, and certain clubs), as well as nonprofit bingo operators not included in category (a).

On January 1, 2005 the LC must determine the number of electronic scratch ticket terminals that are available to be distributed to qualifying business entities. Of that number of machines, which currently is 18,225, the LC must allocate 49 percent of the machines to food and drink establishments, although no licensee in this category may receive fewer than four machines, or more than 24 machines. The number of machines allocated to each entity in this category depends on the annual gross gambling receipts that the licensee received between 1999 and 2002. The house-banked card rooms and the horse racing facility must be allocated 36 percent of the machines; and the 40 largest charity bingo operators must be allocated the remaining 15 percent, although no facility in either of these two categories may be allocated more than 125 terminals per licensed location.

In determining this initial allocation, the LC must also divide the total number of machines available to be distributed to all licensees within each category by the number of licensees in order to calculate an average. No licensee in either category (a) or category (b) may be allocated more than the average for that category.

After the initial allocation of electronic scratch ticket terminals, the LC must annually reassess the number of terminals that may be re-allocated due to under-allocation, forfeiture, or additional machines being allocated to the Tribes.

Licensees may lease their allotted machines to other licensees and may enter into revenue-sharing arrangements with electronic scratch ticket licensees and others licensed by the Gambling Commission.

Only persons aged 21 and older may play electronic scratch ticket machines. Licensees offering electronic scratch ticket machines are required to locate the machines only in areas of the facility where liquor is sold or that otherwise comply with the barrier and signage requirements of the Liquor Control Board.

The requirement that the LC seek legislative approval before entering into another multi-state shared game, such as Mega Millions, is removed.

## Revenue Background

### Taxes on Gambling

Currently the state does not impose a specific tax on gambling. The general business & occupation tax applies to gross revenues received from gambling activities. Most gambling activities are taxed under the service classification at the rate of 1.5 percent. By rule, most gambling activities are taxed on the basis of the gross gambling receipts activities less the monetary value or, in the case of merchandise, the actual cost, of any prizes that are awarded.

Counties, cities, and towns may tax punch boards and pull tabs, social card games, bingo, amusement games, and raffles within their jurisdictions. This local tax is imposed on gross receipts less the amount paid out as prizes. Social card games are the exception, as they are taxed solely on gross receipts. These taxable activities and rates are as follows:

<u>Taxable Activity</u>	<u>Maximum rate</u>
Punch boards & pull tabs	10%
Social card games	20%
Bingo/raffles	5%
Amusement games	2%

Alternatively, counties, cities, and towns may tax punch boards and pull-tabs at 5 percent of gross receipts instead of 10 percent of gross receipts less the amount paid out as prizes.

### Property Tax

All property in this state is subject to the annual property tax based on its market value, unless a specific exemption is provided by law. Under the state Constitution, aggregate property taxes for any individual parcel of property are limited to 1 percent of value, or \$10 per \$1,000 of assessed value, without a vote of the people. Of this \$10, the state levy is limited to \$3.60. For taxes collected in calendar year 2006, the state levy rate is projected to be \$2.50 per \$1,000 of assessed value and expected to generate \$1.6 billion in revenue. All revenue collected from the state levy is dedicated to support the common schools.

## Revenue Summary

### New Gambling Tax

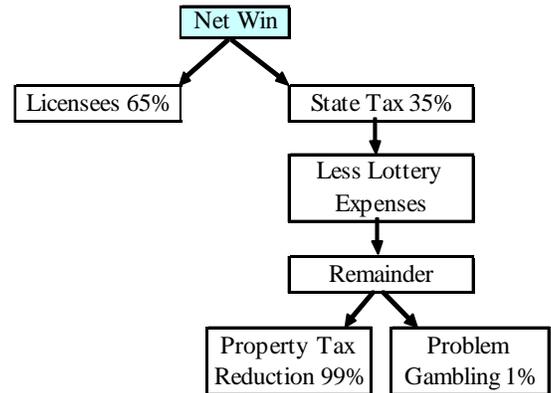
If Initiative 892 is adopted, a new state tax is imposed on non-tribal gambling establishments equal to 35 percent of the net win from electronic scratch ticket machines.

Net win is defined as gross wagers less the amount paid as prizes, the cost of merchandise awarded, accrual of prizes for progressive jackpot contests, and repayment of amounts used to seed progressive jackpot prizes. Initiative 892 requires a minimum machine payout of 75 percent, although the typical industry payout averages around 90 percent per machine.

Of the net win, 65 percent remains with the licensee. Licensees are responsible for the costs

incurred in owning and operating electronic scratch ticket terminals.

The revenues from the 35 percent state tax are deposited into the newly created Electronic Scratch Ticket Account. After deduction of state lottery administrative expenses related to electronic scratch ticket games, 99 percent of the revenues from the tax are to be deposited into the newly created Equal Treatment Equals Lower Property Taxes Account. One percent of the revenues from the tax is to be distributed to a nonprofit entity providing services necessary to address problem gambling, subject to appropriation. Initiative 892's revenue flows are mapped in the adjacent diagram.



Property Tax

Starting in calendar year 2007, and each year following, the state property tax levy will be reduced by the sum of the previous year's deposits into the Equal Treatment Equals Lower Property Tax Account.

Fiscal Impact

The LC anticipates a statewide electronic scratch ticket system would be ready by the end of 2005. Based on staged deployment of 18,225 electronic scratch ticket terminals, the LC assumes that 500 terminals could be in place by January 2006, rising to 13,100 by July 2006 and 18,225 by January 2007. The Office of Financial Management assumes net revenue per machine would

<b>Revenues from Initiative 892</b>				
(Revenue in Millions)				
	<u>CY 2006</u>	<u>CY 2007</u>	<u>CY 2008</u>	<u>CY 2009</u>
<b>Net Win</b>	\$277.0	\$690.3	\$742.5	\$742.5
<b>Distribution of Net Win</b>				
Licensees @ 65%	\$180.1	\$448.7	\$482.6	\$482.6
State tax @ 35%	\$97.0	\$241.6	\$259.9	\$259.9
<b>Distribution of State Tax</b>				
Deduct lottery operating expenses	\$5.5	\$5.1	\$5.3	\$5.3
<b>Distribution of Remainder</b>				
Property tax reduction @ 99%	\$90.6	\$234.1	\$252.0	\$252.0
Problem gambling @ 1%	\$0.9	\$2.4	\$2.5	\$2.5

be about \$112 per operating day. Given these assumptions, the Office of Financial Management estimates revenues from electronic scratch tickets and their distribution to be as follows:

According to the Office of Financial Management, the reduction in the state property tax levy and the state property tax levy rates are shown below:

<b>State Property Tax under I-892</b>						
	<b>State Levy (in Millions)</b>			<b>State Levy Rate (Dollars per \$1,000 of value)</b>		
	<b>Before I-892</b>	<b>I-892 Reduction</b>	<b>After I-892</b>	<b>Before I-892</b>	<b>I-892 Reduction</b>	<b>After I-892</b>
<b>CY 2006</b>	\$1,629	\$0	\$1,629	\$2.50	\$0.00	\$2.50
<b>CY 2007</b>	\$1,680	\$91	\$1,589	\$2.43	\$0.13	\$2.30
<b>CY 2008</b>	\$1,732	\$234	\$1,498	\$2.34	\$0.31	\$2.03
<b>CY 2009</b>	\$1,783	\$252	\$1,531	\$2.28	\$0.32	\$1.96

The effect of the state property tax reduction on households and businesses will vary by the value of the residence or business subject to tax. The property tax reduction for property with an assessed value of \$100,000 will be approximately \$13 in calendar year 2007 rising to \$32 per year in calendar year 2009. The following table illustrates the effect of the tax reduction based on value, assuming full implementation of Initiative 892.

<b>State Property Tax Reduction under I-892 by Value</b>					
	<b>Assessed Value of Property</b>				
	<b>\$100,000</b>	<b>\$150,000</b>	<b>\$200,000</b>	<b>\$500,000</b>	<b>\$1,000,000</b>
<b>CY 2007</b>	\$13	\$20	\$26	\$65	\$130
<b>CY 2008</b>	\$31	\$47	\$62	\$155	\$310
<b>CY 2009</b>	\$32	\$48	\$64	\$160	\$320

The LC estimates implementation of electronic scratch ticket games will result in decreased demand for other LC products, such as Scratch Tickets, Mega Millions, and Lotto. Revenues from LC products is directed into the Education Construction Account. The Office of Financial Management estimates this account will currently receive \$196.1 million for the 2005-07 biennium and \$185.3 million for the 2007-09 biennium. Under Initiative 892, The Office of Financial Management estimates revenues in the Education Construction Account will be reduced by \$19.3 million in the 2005-07 biennium and \$60.0 million in the 2007-09 biennium.

Electronic scratch ticket games may also displace demand for punch boards and pull tab games, which are gambling activities taxed by cities, towns, and counties. The state Gambling Commission estimates that local gambling tax revenues may decline by as much as \$7.5 million in 2007 and by \$8.4 million in 2008 and in 2009.