

May 2017

TO: Members of the Legislative Budget and Finance Committee

FROM: Philip R. Durgin, Executive Director

SUBJECT: Annual Report Required by Act 2013-90: The Impact of Tavern Gaming on the Pennsylvania State Lottery

Act 2013-90, an amendment to the Local Option Small Games of Chance Act, requires the Legislative Budget and Finance Committee to conduct an annual study of the impact of tavern gaming on the State Lottery. Under the act, the Governor may request the General Assembly to transfer money from the General Fund to the State Lottery Fund up to the amount identified in the study. This is the second report under this mandate.

Role of the Pennsylvania Gaming Control Board, the Liquor Control Board, and the Pennsylvania Department of Revenue. Applications for tavern gaming licenses are filed with the Pennsylvania Liquor Control Board (PLCB). The Pennsylvania Gaming Control Board (PGCB) then conducts a background investigation on the applicant through *its* Bureau of Investigations and Enforcement (BIE).

Upon completion of background investigations, the BIE transmits its report to the PLCB for its consideration in determining whether to award a license, including reviewing the information to determine if the applicant is financially stable and responsible, has sufficient business experience and the ability to effectively operate tavern games, and is of good character. The PLCB has six months upon receipt of the investigation report to approve or disapprove the application. As of April 2017, the PLCB had 56 active licensed tavern gaming establishments.

The Department of Revenue (DOR) licenses small games of chance distributors and receives quarterly and annual reports from licensees on the net revenue of the games and the taxes due. DOR is also to conduct random audits of 5 percent of all club licensees and otherwise enforce the provisions of the act relating to enforcement and tax collections.

Cost to Applicants. To apply, individuals must submit \$2,000 to the PLCB (a \$1,000 application fee and a \$1,000 investigation fee), along with a completed application packet. If an applicant is approved, the licensee must pay an additional \$500 fee.¹ There is also an annual renewal fee of \$1,000 per license. The application fee and background check fees are non-refundable.

¹ The original fee was \$2,000. This was lowered by the Liquor Control Board to \$500 in July 2014.

The Gaming Control Board receives a minimum of \$1,000 to cover the cost of its background investigation. If the cost of conducting the background investigation increases, the applicant must pay those additional costs. The Pennsylvania Liquor Control Board retains the \$1,000 licensing fee to cover its administrative costs.

Allowable Tavern Games. Under Act 90, tavern owners are allowed to sell raffles (for a charitable or public purpose), pull-tab games, and daily drawings at certain licensed establishments. Pull tabs are defined in the act as “a single folded or banded ticket or a strip ticket or card with a face covered to conceal one or more numbers or symbols, where one or more of each set of tickets or cards has been designated in advance as a winner.” Tavern daily drawings are games in which a person selects or is given a number for a chance at a prize. The winner is chosen by random drawing. Chances may not be sold for more than one dollar, and no more than one chance per person may be sold per drawing.

The proceeds from pull tabs and daily drawings are subject to a 60/35/5 split, where 60 percent of the net revenues obtained in a year are paid to the Commonwealth, 35 percent can be retained by the licensee, and 5 percent goes to the municipalities that host tavern games. Net revenue is defined in the bill as the difference between the face value collectible by a licensee from a tavern game and the maximum amount of prizes payable by a licensee from a tavern game.

Tavern raffles are defined as raffles held for a charitable or public purpose, subject to the following restrictions:

- No more than one tavern raffle may be held in a calendar month.
- No tavern game may have any single prize higher than \$2,000.
- No more than \$35,000 may be awarded through tavern games in any consecutive seven-day period.

At least 50 percent of the net revenues from the tavern raffle must be given to the designated charity within seven days of the raffle. Any net revenues not given to the designated charity are to be distributed as follows:

- 60 percent is paid to the Commonwealth (the Tavern Games Tax),
- 35 percent may be retained by the licensee, and
- 5 percent is paid to the Commonwealth for payment to the host municipality (the Host Municipality Tavern Games Tax).

The Impact of Tavern Gaming on the State Lottery. When Act 90 was being debated, the Governor’s Office of the Budget estimated that 2,000 establishments would be licensed under the act, generating an average weekly payout of \$10,000 per license. Using this assumption, the legislation was estimated to generate total

annual net revenue of \$156 million, which in turn would generate (at a 60 percent tax rate) \$93.6 million in additional revenues for the General Fund annually.

Actual state revenues, however, have been far lower. In CY 2014, tavern games generated approximately \$153,000 in state tax revenue, increasing to \$1.42 million in 2015 and \$1.48 million in 2016.

The \$1.48 million in tavern revenue collected in 2016 represents about \$2.46 million in patron losses (gross sales minus prizes), as compared to about \$1.48 billion in losses for persons participating in Lottery games. Because tavern gaming losses are less than two-tenths of 1 percent (0.17 percent) of the losses incurred from playing Lottery games, we concluded the patron losses due to tavern gaming could not have a material impact on State Lottery sales.

Expensive up-front license fees, intrusive background checks, and an unfavorable tax scheme have been cited as some of the reasons for low participation among tavern owners.