

TAVERN GAMING 2019



March 2019

TO: Members of the Legislative Budget and Finance Committee

FROM: Patricia A. Berger, Executive Director

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

Why we conducted this study...

Act 2013-90 authorized small games of chance in Pennsylvania's taverns. It also directed the Legislative Budget and Finance Committee (LBFC) to complete an annual study of tavern gaming's impact on Pennsylvania Lottery revenues.

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 on the impact of tavern gaming on the State Lottery. Under the act, the Governor may request the General Assembly to appropriate money from the General Fund to the State Lottery Fund up to the amount identified in the study. This is the fourth report under this mandate.

The Impact of Tavern Gaming on the State Lottery.

When Act 2013-90 was debated, the Governor's Office of the Budget estimated 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 tavern gaming tax revenues, however, have been far lower than originally projected. In CY 2014, tavern games generated approximately \$153,000 in tax revenue. The amount has increased in successive years, with \$1.64 million in tavern games and host municipality tax revenue in CY 2018. Exhibit 1 shows these tax revenues, for CYs 2015-2018, and Lottery revenues for the same period.¹ For CY 2018, tavern game revenues were 0.10 percent of Lottery revenues.

¹ Lottery revenue figures are total sales minus prize liability. Tavern revenues are 65 percent of total sales minus prize liability.

In 2017, Act 2017-42 authorized iLottery,^{2,3} allowing patrons to play lottery games through the internet. The State Lottery Fund began receiving iLottery revenues in May 2018.⁴ For the period of May 2018 through December 2018, iLottery's gross revenues were \$163.50 million, which when added to traditional lottery revenues yielded a total of \$4.55 billion in gross revenues.⁵ The 2018 lottery figures in this report are presented with traditional PA Lottery and iLottery combined.

Exhibit 1

Tavern Games Tax and Lottery Revenue*
CY 2015-2018

<u>Calendar Year</u>	<u>Tavern Games Tax Revenue</u>	<u>Lottery Revenue</u>	<u>Tavern Tax Revenues to Lottery</u>
2015	\$1,415,633	\$1,420,959,525	0.10
2016	1,566,229	1,481,843,213	0.11
2017	1,443,622	1,464,025,910	0.10
2018	1,638,406	1,564,421,796	0.10

Note: *Includes both state and municipal shares of tavern gaming tax revenues.

Source: Developed by LBFC staff with data provided by the Department of Revenue.

The \$1.44 million in tavern game and host municipality tax revenue collected in CY 2017 represents about \$2.22 million in patron losses; as compared to about \$1.46 billion in patron losses for persons participating in Lottery games that year, as shown in Exhibit 2. Tavern gaming patron losses were less than two-tenths of one percent (0.15 percent) of the losses incurred by those playing Lottery games. For CY 2018, this number rose slightly to 0.16 percent, with lottery patron losses at \$1.56 billion and tavern games patron losses at \$2.52 million. This ratio has remained very steady for the four years of this study, ranging from 0.15 to 0.16 percent.

² iLottery is defined as “a system that provides for the distribution of lottery products through numerous channels that include, but are not limited to, web applications, mobile applications, mobile web, tablets and social media platforms that allow players to interface through a portal for the purpose of account management, game purchase, game play and prize redemption.”

³ In August 2018, seven casino organizations filed suit against the Department of Revenue, claiming that iLottery offers interactive games and games that simulate slot machines and casino-style games in violation of both the State Lottery law and Act 2017-42. The case is ongoing.

⁴ A provision of Act 1971-91 specifies that part of the apportionment of total revenues from the sale of lottery tickets is “for property tax relief and free or reduced fare transit service for the elderly as provided in section 311.... For fiscal years beginning after June 30, 2014, no less than 25% of the total revenues accruing from the sale of lottery tickets or shares shall be dedicated to this subparagraph.” Because of a provision in Act 2017-42, iLottery revenues were only subject to this profit margin limitation until the beginning of FY 2018-19 (May and June 2018), and exempted from that provision thereafter.

⁵ Gross revenues are lottery sales.

Exhibit 2

Ratio of Lottery Patron Losses to Tavern Game Patron Losses
CY 2015-2018

<u>Calendar Year</u>	<u>Lottery Patron Losses</u>	<u>Tavern Game Patron Losses</u>	<u>Tavern Games to Lottery</u>
2015	\$1,420,959,525	\$2,177,897	0.15%
2016	1,481,843,213	2,409,583	0.16
2017	1,464,025,910	2,220,956	0.15
2018	1,564,421,796	2,520,624	0.16

Source: Developed by LBFC staff with data provided by the Department of Revenue.

Because tavern gaming losses were so low compared to lottery losses, and have remained consistently low since we started issuing this report, we concluded that patron losses due to tavern gaming did not have a material impact on State Lottery sales. Further supporting this conclusion, tavern revenues have remained at 0.10 to 0.11 percent of lottery revenues for the past four years.

See Appendix A for the response to this report from the Department of Revenue and the Pennsylvania Lottery.

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 the report to the PLCB for its consideration in determining whether to award a license. Items included in the report contain information to determine if the applicant is financially stable and responsible, has sufficient business experience, has 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 January 2019, the PLCB has approved 64 tavern gaming licenses, of which 50 are active.⁶

The Department of Revenue (DOR) licenses small games of chance distributors. It also receives quarterly and annual reports from tavern licensees on the net revenue of the games and the taxes due. DOR is also responsible for administering the provisions of the act relating to enforcement and tax collections.

⁶ Tavern gaming licenses may be inactive because they were not renewed, or because they were transferred with a liquor license.

Cost to Applicants.

To apply, individuals must submit \$2,000 to the PLCB (a \$1,000 application fee to the PLCB and a \$1,000 investigation fee to the PGCB), with a completed application packet. If an application is approved, the licensee must pay an additional \$500 license fee.⁷ There is also an annual renewal fee of \$1,000 per license. The application fee and background check fees are non-refundable.

The PGCB receives the \$1,000 investigation fee to cover the cost of its background investigation. If the cost of conducting the background investigation exceeds the fee, the applicant must pay all additional costs. The PLCB retains the \$1,000 licensing fee to cover its administrative costs.

Allowable Tavern Games.

Under Act 90, tavern owners may sell a variety of games, including pull-tab games, daily drawings, and raffles at 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 a 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 may be retained by the licensee, and 5 percent goes to the municipalities where taverns are located (Host Municipality Tavern Games Tax). Net revenue is defined in the statute 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.

Raffles, which may only be held for a charitable or public interest purpose,⁹ may be held no more than one time in a calendar month. 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 by the same 60/35/5 split as defined above.

⁷ The license fee was originally \$2,000. This was lowered by the PLCB to \$500 in July 2014.

⁹ A public interest purpose is one or more of the following:

- (1) The activities and operations of a nonprofit benevolent, religious, educational, philanthropic, humane, scientific, patriotic, social welfare, social advocacy, public health, public safety, emergency response, environmental, or civic objective.
- (2) Initiating, performing, or fostering worthy public works or enabling or furthering the erection or maintenance of public structures.
- (3) Lessening the burdens borne by government or voluntarily supporting, augmenting, or supplementing services which government would normally render to the people.
- (4) Improving, expanding, maintaining, or repairing real property owned or leased by an eligible organization and relating operational expenses used for purposes specified in paragraphs (1), (2), and (3).

APPENDIX



Appendix A – Agency Response



March 14, 2019

Patricia A. Berger, Executive Director
Legislative Budget and Finance Committee
400 Finance Building,
613 North Street,
Harrisburg, PA 17102-8737

Dear Ms. Berger,

The Department of Revenue and Pennsylvania Lottery are providing written comments for inclusion in the 2019 Impact of Tavern Gaming on the Pennsylvania State Lottery annual report commissioned by the Legislative Budget and Finance Committee (LBFC) pursuant to the requirements set forth in Act 90 of 2013.

Although the department agrees with the Legislative Budget and Finance Committee's general conclusion that the impact of tavern games on the Pennsylvania Lottery has been minimal since the implementation of Act 90 of 2013, there are other factors to consider when examining this issue.

For example, further analysis of sales for specific Lottery retailers could give us more information to have a more complete understanding of the impact of tavern gaming. This analysis could include Lottery retailers who are located in close proximity to establishments that offer tavern gaming. There is a likelihood that Lottery retailers in this situation are affected by nearby competition.

There is also a possibility that establishments with tavern gaming also sell Pennsylvania Lottery products, or did in the past. If we were to analyze specific retailers that meet this criteria, that data could give us more information to consider when determining the true effect.

It should also be said that further expansion of tavern games under Pennsylvania law would very likely make it more difficult for the Lottery to fulfill its mission of responsibly generating funds for older Pennsylvanians. To put this point in context, I should note that the Lottery has launched several new products over the last year to remain competitive in a rapidly changing business environment. That includes monitor-based games, including Keno and Xpress Sports, which were authorized by Act 42 of 2017.

We are making an active push to recruit new Lottery retailers and encourage existing retailers to offer these games, which are popular in bars and taverns. Creating further competition for these games would undoubtedly make it more difficult for the Lottery to build on its success in launching these new products. Increased competition could also very likely be a detriment to the Lottery's traditional games, which remain the core of our business.

We would also be remiss if we did not call your attention to the proliferation of unregulated and untaxed "Games of Skill" machines. Although these games fall outside the scope of the LBFC's

report, it is important to mention their impact to provide further context concerning the additional competition the Lottery is facing in today's environment.

Currently 1,761 Lottery retailers house one or more Games of Skill, which is a direct threat to Lottery dollars for older Pennsylvanians. These machines not only are competing within our retailers, but also are preventing the Lottery from recruiting new retailers that tend to favor the unregulated and untaxed machines.

When we compare the performance of Lottery retailers with and without Games of Skill, we find a marked difference in Lottery sales. From our analysis, \$95 million is lost per year in scratch-off sales to these illegal machines. Put another way, approximately 3.4 percent of total scratch-off sales are currently being cannibalized by these machines. These figures only measure the direct impact of Games of Skill; there may be additional indirect losses due to Games of Skill that are operating outside of our Lottery retailers.

It is clear that Games of Skill machines in Pennsylvania are a direct, effective, and formidable competitor to the Lottery in the retail environment. We find the potential for hundreds of millions of dollars in future harm, as well as \$95 million in already-realized harm, from the proliferation of these machines in Pennsylvania. We believe that the impact of these machines shows the extent to which offering alternative forms of gaming in the retail environment can impact the Lottery. As a result, any potential expansion of tavern games could very easily have a similar impact on our ability to responsibly generate funds for the programs that benefit older Pennsylvanians.

Thank you for the opportunity to provide written comments to the annual tavern games impact report pursuant to Act 90 of 2013

Sincerely,



Drew Svitko
Pennsylvania Lottery