



Revenue Sharing and Free Play

by Ryan Burns

In order to survive the current economic downturn many gaming operators have had to become more efficient and effective to successfully adapt to the increasingly competitive gaming market. With casino patrons becoming more value conscious and sophisticated when comparing casino promotional offers and rewards, casinos have had to become more innovative and enticing in their marketing schemes. In turn, operators have had to balance projected gains received from these promotional offers with the costs associated with providing them. Not to be outdone, state and local governments (SLGs) have also become more aggressive at targeting gaming revenues as a means to bridge their own budgetary pitfalls. Gaming operators in locations throughout the United States are currently engaged in debates with SLG officials and representatives relating to the ever-increasing role the gaming industry is expected to play in supplementing the local tax base through tribal 'revenue sharing' and 'community impact' payments.

While some SLGs have been actively pursuing a higher percentage of net gaming revenues to call their own, others have attempted to redefine the items included in the net gaming revenue calculation or taxable base. In certain jurisdictions (Connecticut, Oklahoma, New Mexico, etc.) state regulators have asserted their ability to assess revenue sharing payments from tribal casinos on 'free play' amounts. This revenue is in addition to the actual net gaming revenue already collected from patrons.

Free play, or no-cost wagering, consists mainly of credits that can be used for play on gaming machines that are downloaded from a players' loyalty club card, inserted from a promotional ticket, or negotiated through match play coupons used at a table game position. In most, if not all situations, free play cannot be 'cashed out' and must be cycled or played at the respective gaming position; only winnings on free play are paid or credited to the patron's account as redeemable credits.

Effectively proposing to tax or collect revenue sharing from gaming revenues that were never collected appears to be an overly opportunistic and an inappropriately conceived idea from the SLGs. In reality, this issue could be destined to become another unjust regulatory and economic burden that operators and the membership of sovereign tribal governments can hardly afford. When contemplating the idea of requiring revenue sharing or tax assessments on free play issued to patrons, state, tribal, and other local officials should take into consideration the following concepts:

Free Play Represents a Reduction of House Hold

The effect of offering free play to customers is substantially equivalent to lowering the machine or table games'

theoretical hold percentages. By offering a lower hold percentage (higher payback percentage to the patron), the gaming operator hopes to generate more gaming net win through increased volume of play on the respective games.

Tax and Revenue Sharing on Free Play – Non-Gaming Considerations

Application of taxation on similar incentives has not been implemented throughout other industries. Consider this concept when using your loyalty club card at your local grocery store, hotel, airline, or rental car company, or when using coupons, rebates and other promotions for sales discounts in your everyday life. Grocery stores are not required to pay income or remit sales taxes on coupons and other price reductions provided to customers through 'club cards' or other loyalty groups and cooperatives. Taxes are not assessed on the airlines for every 'mile' issued or promotional ticket provided.

Generally Accepted Accounting Principles (GAAP)

Generally accepted accounting principles (GAAP) encompass standards and other guidance issued or codified by the Governmental Accounting Standards Board (GASB), Financial Accounting Standards Board (FASB), other lower level guidance issued by the American Institute of Certified Public Accountants (AICPA), and other sources including standards normally used in industry practice. During 2008, the AICPA issued an updated draft of the revised *Gaming Audit and Accounting Guide*, which addresses the accounting treatment for loyalty program benefits and free play. The guide is reportedly in the process of approval from the FASB and GASB staff and is set to be implemented into practice sometime during 2010. The revised guide specifically requires that the cost of free play (which is the increased chance of providing cashable benefits to the patron) be reported naturally as a reduction of net win. To more clearly reiterate the AICPA's position, it would be correct to state that if free play was included in gross revenue derived from handle or coin-in, it should be subtracted out to correctly arrive at net gaming revenue for financial reporting purposes. All gaming operations that are required to have an external financial statement audit are required to present their financial statements in accordance with GAAP to receive an unqualified 'clean' audit opinion.

Inconsistencies in Jurisdictional Application

While each jurisdiction and sovereign tribal government's gaming environment is governed by independent

regulations, ordinances, and approved tribal-state Class III gaming compacts, it is also noteworthy to demonstrate that most jurisdictions, including the mature regulatory regulations of the Nevada Gaming Control Board and National Indian Gaming Commission, exclude free play from the computation of 'taxable' net win in the determination of fees.

SLGs and Gaming Operators Have Common Interests

SLGs participate with the respective gaming operators as payments required to be made under tribal-state compacts and tax provisions are, in most cases, and in general, based on a percentage of net gaming win (revenue). When considering that the issuance of free play by management of the gaming operations to patrons was issued not for the purpose of avoiding payments to the SLGs, but to produce higher net gaming revenue; SLGs might be better positioned to consider encouraging the issuance of free play.

When considering these described concepts, it appears that gaming operators are better suited to drive higher net gaming revenues (and therefore higher revenue sharing payments to SLGs) rather than the representatives and administrators of SLGs. In the financial interests of both the SLGs and gaming operators, free and match play should fundamentally not be subject to tax, revenue sharing, or community impact payments, and the levels of such incentives offered to customers should be at the discretion of the experienced gaming operators without consideration of additional economic penalty. In addition, the computation of taxable net win should mirror concepts utilized by generally accepted accounting principles in order to minimize differences between net win per the audited financial statements and the taxable net win reported to the SLGs. ♣

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