

Department of Legislative Services
Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 959

(Senator Middleton, *et al.*)

Budget and Taxation

Ways and Means

Slot Machines - Definition

This bill alters the current prohibition on slot machines to include a machine that reads a game of chance and a machine that delivers a game of chance. The bill provides for exceptions for certain machines that are not considered slot machines.

The bill also allows existing qualified organizations and licensed operations of specified electronic instant bingo machines that would otherwise be illegal under the bill to remain in operation until July 1, 2009. To remain in operation, the bill requires that the conduct of the gaming and operation of the machines are consistent with all other criminal law provisions.

Finally, the bill provides that implementation and enforcement of the bill may not be stayed if any legal action is brought to challenge the bill.

The bill does not apply to slot machines authorized for use on the Eastern Shore by eligible organizations.

The bill takes effect July 1, 2008.

Fiscal Summary

State Effect: General fund revenues could decrease beginning in FY 2009 by an indeterminate amount and by an estimated \$5.0 million annually beginning in FY 2010 as a result of the Comptroller's Office no longer collecting the State admissions and amusement tax on these electronic machines. General fund revenues could increase by an indeterminate amount due to increased lottery sales. The bill would have little operational effect on the Comptroller or State Lottery.

(in dollars)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
GF Revenue	(-)	(\$5,000,000)	(\$5,000,000)	(\$5,000,000)	(\$5,000,000)
Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	\$0	(\$5,000,000)	(\$5,000,000)	(\$5,000,000)	(\$5,000,000)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Loss of county admissions and amusement tax revenues. Minimal increase in revenues and expenditures due to the bill’s penalty provision. **This bill imposes a mandate on a unit of local government.**

Small Business Effect: Overall minimal; however, to the extent that slot machines prohibited under the bill provide revenues to a local establishment, revenues will decline.

Analysis

Bill Summary: This bill alters the definition of “slot machine” to include a machine that reads a game of chance and a machine that delivers a game of chance. The bill also provides for exceptions for certain machines that are not considered slot machines:

- machines that award the user additional free games;
- machines that are arcade-type games that provide noncash prizes of minimal value; and
- paper pull tab tip jars and paper pull tab instant bingo tickets that must be opened manually as long as the machine does not electronically read the ticket, does not alert the user to winnings, or does not tabulate the winnings.

Personal electronic bingo machines are also excluded as long as the machine does not allow a person to play more than 54 cards at one time. The bill also excludes State Lottery Commission machines that dispense lottery tickets and video lottery terminals (VLTs) if they are approved via constitutional amendment in November 2008.

To remain in operation until July 1, 2009, the electronic instant bingo machines must have been in operation for a one-year period ending December 31, 2007. In addition, no more than the number of electronic machines operated as of February 28, 2008 may be in operation by the qualified organization or commercial bingo licensee.

A county may not issue a commercial bingo license to an entity that was not licensed to conduct commercial bingo on or before June 30, 2008.

Finally, the State Lottery Agency must submit a report regarding gaming activities in local jurisdictions to the Governor and specified legislative committees by December 15, 2008.

Current Law: A gaming device is prohibited in the State if it is: • a gaming table, except a billiard table, at which a game of chance is played for money or any other thing or consideration of value; or • a game or device at which money or any other thing or consideration of value is bet, wagered, or gambled. Gaming devices include a paddle wheel, wheel of fortune, chance book, and bingo.

A person may not: • bet, wager, or gamble; • make or sell a book or pool on the results of a race, contest, or contingency; • establish, keep, rent, use, or occupy, or knowingly allow to be established, kept, rented, used, or occupied, all or a part of a building, vessel, or place on land or water, within the State for the purpose of:

- betting, wagering, or gambling;
- making, selling, or buying books or pools;
- receiving, becoming the depository of, or forwarding money or any thing of consideration of value, to be bet, wagered, or gambled on the result of a race, contest, or contingency.

Local Gaming

Each county is responsible for regulating gaming activities conducted by civic and charitable organizations. There is no statewide reporting of gaming activities by civic and charitable organizations. Gaming licensees may use the proceeds of gaming activities for the benefit of their own organizations, but do not need to share them with other organizations. However, slot machine operators must use half of the proceeds from slot machines to benefit a charity. State gaming law requirements currently apply to 15 counties.

Facilities operating electronic bingo are located primarily in Allegany, Anne Arundel, and Calvert counties. Tip jar gaming, predominantly paper based, is conducted in several Western Maryland counties, including Allegany, Garrett, and Washington.

Legislation was enacted in 1987 and 2007 authorizing certain nonprofit organizations to operate slot machines in the following eight Eastern Shore counties: Caroline, Cecil, Dorchester, Kent, Queen Anne's, Somerset, Talbot, and Wicomico. The 1987 legislation required a nonprofit organization to be located in the county for at least five years prior to the application for a license and to be a fraternal, religious, or war veterans' organization. Legislation enacted in 2007 expanded the list of eligible organizations that may be licensed to operate slot machines to include those that have been affiliated with a national fraternal organization for less than 5 years but have been located within an eligible county for at least 50 years before applying for a license.

In order to operate a slot machine, an organization must obtain a license from the sheriff's office and pay a fee of \$50 per machine annually to the applicable county. An organization may not own more than five slot machines and must own each slot machine in operation. The slot machines must be located at the principal meeting hall of the organization and cannot be operated at a private commercial facility. The slot machine must be equipped with a tamperproof meter or counter that accurately records gross receipts.

One-half of the proceeds generated from slot machines must go to charity. The remainder of the proceeds must go to the organization. An individual cannot benefit financially from the proceeds. The organization must keep accurate records of gross receipts and payouts from slot machines and must report annually under affidavit to the Comptroller's Office the disposition of these proceeds. The Comptroller's Office, however, does not have authority to audit these reports.

Admissions and Amusement Tax

At the 2007 special session, the General Assembly approved legislation (Chapter 6) that imposed a 20% State admissions and amusement tax on the net receipts generated from the operation of electronic bingo and electronic tip jars operated for commercial purposes. The revenues accrue to the general fund. This provision took effect January 3, 2008.

In addition, all counties (with the exception of Caroline County), Baltimore City, and most municipalities impose a local admissions and amusement tax. Each unit of local government sets its own single tax rate or range of rates. This rate is expressed as a percentage of gross receipts, up to a maximum rate of 10%.

Each unit of local government is authorized to classify different types of activities, and the rate of tax need not be the same for each type. An admissions and amusement tax may not be imposed in a municipality by a county if the municipality already imposes a similar tax or specifically exempts any gross receipts from the admissions and amusement tax.

However, if a municipality does not levy a tax, the county tax, if any, applies within the municipality. The local admissions and amusement tax is further limited by the State sales and use tax.

The maximum tax rate on the gross receipts subject to admissions and amusement tax may not exceed 10%. If the 6% State sales and use tax also applies to these receipts, the local admissions and amusement tax may not exceed 5%. This limitation on the local tax

arises primarily on performances accompanied by some type of food service (dinner theaters, etc.).

The Comptroller collects the local (*i.e.*, county or municipal) admissions and amusement tax and remits payment back to the local jurisdictions on a quarterly basis. The Comptroller also collects the 20% State admissions and amusement tax, which is levied on net proceeds (*i.e.*, after cash and prizes are paid out). In general, the admissions and amusement tax applied by the local jurisdictions is a gross receipts tax. The notable exception is Anne Arundel County, which allows for the prizes and cash awards from the electronic bingo parlors to be subtracted out.

On January 18, 2008, the Comptroller of Maryland promulgated updated regulations to address concerns regarding the terms “electronic bingo” and “electronic tip jars.” Pursuant to State regulations, an electronic bingo or electronic tip jar is a game played in an electronic or electro-mechanical device that contains predetermined winning and losing games and signals the issuance of a winning play. Examples include (but are not limited to):

- electronic devices utilizing paper bingo or tip jar tickets; and
- electronic devices utilizing computer chips that simulate paper bingo or tip jar tickets that, when played by a customer, determine the outcome of winning or losing that is not random or subject to change, but is based on a predetermined set of winning or losing numbers.

Background: Two pieces of legislation were enacted at the 2007 special session pertaining to VLT gambling.

Chapter 5 is a constitutional amendment that will be submitted to the voters at the November 2008 general election proposing that the General Assembly may only authorize expanded forms of gambling subject to the following restrictions: • a maximum of 15,000 VLTs may be authorized; • a maximum of five VLT facility licenses may be issued at locations specified in the bill; and • VLT facilities shall comply with all applicable planning and zoning laws of the local jurisdictions. Under the amendment, the General Assembly may not authorize any additional forms or expansion of commercial gambling except through enactment of legislation passed by a majority of each house of the General Assembly, which would then be subject to voter approval via referendum. The constitutional amendment does not apply to currently authorized forms of gambling.

Chapter 4 establishes the operational and regulatory framework for the proposed VLT program. Enactment is contingent on ratification of Chapter 5 at the 2008 general election. VLT oversight will be provided by a nine-member State Lottery Commission,

and the commission will own/lease the VLTs and the central monitor and control system. Allocation of the gross VLT revenues, after payouts to bettors, is as follows:

- **Business Investment:** 1.5% to a small-, minority-, and women-owned business investment account;
- **State Lottery:** 2% to the Lottery for administrative costs, with other costs provided for in the annual State budget;
- **Local Government:** 5.5% to local governments where a video lottery facility is operating, 18% of which would go for 15 years (starting in fiscal 2012) to Baltimore City through the Pimlico Community Development Authority and to Prince George’s County for the community surrounding Rosecroft (\$1 million annually);
- **Horse Racing Industry:** 7% to a purse dedication account to enhance horse racing purses and funds for the horse breeding industry, not to exceed \$100 million annually; and 2.5% for an eight-year period to a Racetrack Renewal Account, not to exceed \$40 million annually;
- **Licensee (Operator):** 33% to video lottery operation licensees; and
- **Education Trust Fund:** the remainder to the Education Trust Fund (48.5-51.0%).

Revenues accruing to the Education Trust Fund are to be used for the Bridge to Excellence in Public Schools Act funding (including the Geographic Cost of Education Index), public school construction, and public higher education construction, including community colleges. Legislative Services estimates of the net effect on State revenues, if the referendum submitted to the voters at the November 2008 general election passes, are presented in **Exhibit 1**.

Exhibit 1
Fiscal Summary
Net State Effect if Video Lottery Terminals are Operational

<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>
(\$2,362,400)	\$86,557,600	\$61,071,800	\$422,747,000	\$564,665,200

State Lottery Agency

The lottery, in operation since 1973, is the third largest contributor to the State’s general fund, with general fund revenues of \$473.1 million in fiscal 2007. The general fund
 SB 959 / Page 6

proceeds represent the net “profit” after all expenses are paid, including the costs of administering the State Lottery Agency (\$51.8 million for fiscal 2007) and the distribution of revenues to the Maryland Stadium Authority (\$21.0 million).

The State Lottery Commission, consisting of five members appointed by the Governor, has oversight responsibility for the agency. The agency currently administers eight games, with approximately 3,700 licensed sales agents across the State. Agents receive commissions for selling tickets and cashing winning tickets; in fiscal 2007 agent earnings totaled \$112.2 million, 7.1% of gross sales. Prizes in fiscal 2007 totaled \$919.2 million, more than 50% of total sales.

Exhibit 2 displays the State Lottery Fund’s receipts and disbursements for fiscal 2007 to 2009.

Exhibit 2
State Lottery Fund Overview
Fiscal 2007-2009
(\$ in Millions)

	Fiscal 2007	Fiscal 2008	Fiscal 2009
	<u>Actual</u>	<u>Appropriation</u>	<u>Allowance</u>
Gross Sales	\$1,577.3	\$1,708.7	\$1,756.2
Deductions			
Agent Commissions	112.2	122.3	126.1
Operating Expenses	51.8	57.8	60.0
Prizes	919.2	1,010.0	1,038.8
Total Deductions	1,083.2	1,190.1	1,224.9
 Net Lottery Revenue	 494.1	 518.6	 531.3
 Maryland Stadium Authority	 21.0	 21.5	 23.0
 General Fund Revenues	 473.1	 497.1	 508.3

Note: Figures may not sum due to rounding.

Source: State Lottery Agency; Board of Revenue Estimates

Allegany County

Allegany County indicates there are 80 electronic machines currently operating in the county with 40 of them in a single location. Legislative Services estimates that the gaming market in Allegany County totals approximately \$21.6 million a year. At this time, the industry has a significant share of electronic games run by qualified organizations (*e.g.*, Cumberland Outdoor Club, American Legion). However, the majority of the proceeds (78%) circulate back to winning game participants who win cash prizes. The actual cost of the games supplied to retailers depends upon wholesale market conditions and can vary by the individual wholesale ticket providers who compete in Allegany County to provide operators with paper games. Retail operators purchase tickets in bulk and incur wholesale fees that are approximately 4% of the dollars paid to provide paper games. In addition to paying wholesaler fees, licensed organizations in Allegany County pay county taxes and other county fees before remaining monies are collected.

The Allegany County Gaming Office reports that a total of \$750,153 was collected from taxes, licenses, and stickers in fiscal 2007. The majority of the revenues (92%) were collected from taxes (**Exhibit 3**):

Exhibit 3
Allegany County Revenues from Gaming Operations
Fiscal 2007

Taxes	\$650,153	(92%)
Stickers	48,800	(7%)
Licenses	6,200	(1%)
Total	\$705,153	

For-profit organizations, which are taxed by the county at a 40% rate, contributed approximately \$371,100 in county revenues; qualified organizations, which the county taxes at a 10% rate contributed approximately \$279,100 (**Exhibit 4**). For-profit organizations include taverns, liquor stores, and convenience stores. Qualified organizations include American Legion, Eagle, and VFWs.

Exhibit 4
Allegany County Tax Revenues
Fiscal 2007

	<u>Tax Rate</u>	<u>Tax Revenues</u>
For-profit	40%	\$371,082
Qualified Organizations	10%	<u>279,072</u>
Total		650,153

Anne Arundel County

Anne Arundel County indicates there are three commercial bingo locations in the county. Anne Arundel County code authorizes the three locations. Licensing is provided through the county Department of Inspections and Permits and three license classifications are established with annual fees: Class NA fee (up to 750 people – \$3,000 annual fee); Class NB fee (up to 1,000 people – \$10,000 annual fee); and Class NC fee (up to 2,000 people – \$12,500 annual fee). Currently, two bingo halls have Class NA licenses and one hall holds a Class NC license, resulting in a total of \$18,500 in annual licensing fee revenues to the county. The county imposes an admissions and amusement tax on the “gross receipts” of the three commercial bingo establishments. Effective July 1, 2007, the tax rate was increased from 7.5% to 10.0%.

The Comptroller indicates that there are approximately 200 known electronic bingo machines in the county at these locations. Aggregate gross receipts (revenues received less prizes paid) for the three commercial bingo locations from calendar 2005 to 2007 are presented in **Exhibit 5**.

Exhibit 5
Anne Arundel County
Aggregate Gross Receipts for Commercial Bingo Halls

<u>Calendar Year</u>	<u>Aggregate Gross Receipts</u>	<u>County Revenues</u>
2005	\$11,854,700	\$889,100
2006	\$15,347,200	\$1,086,000
2007	\$21,044,600	\$1,595,800

These figures are in the aggregate for electronic and regular bingo and pull tabs, both paper and electronic. Figures aggregated for the three bingo locations and breakouts for specific types of gambling are not available.

The county advises that all bingo equipment must be purchased by an approved manufacturer or distributor. The annual fee for a county distributor's license is \$2,000, and six distributors are licensed with the county, resulting in \$12,000 in annual county revenues.

Calvert County

There are three known bingo locations in Calvert County with electronic bingo machines. The Comptroller indicates that the largest has 300 known electric bingo machines. The Calvert County State's Attorney advises that the machines are operated in conjunction with a commercial bingo license issued by the county commissioners. There is currently no fee or regulation concerning the machines. The county commissioners are currently considering assessing a fee for each machine – the amount of any fee could be as low as \$200 or as high as \$10,000 per machine.

Since Calvert County does not regulate these machines, the county is unable to provide any information about what private contracting arrangements may be in place between the owner of the license and the owner of the machines. Only commercial businesses are allowed to operate the electronic devices.

Charitable organizations are precluded from having the electronic machines. They are allowed to dispense pull tabs from mechanical machines that do not have the type of player enhancements that the electronic machines possess. Charitable organizations file income reports with the county's Gambling Permit Review Committee.

St. Mary's County

Reports from the St. Mary's Sheriff indicate that St. Mary's County has on the order of 380 gaming devices in 23 locations (an average of approximately 15 machines per location). Some of the larger facilities include St. Mary's Landings, with approximately 35 gaming devices; the Brass Rail, 40 to 45 gaming devices; and ADF Bingo, 60 gaming devices. Nonprofit organizations sponsor and operate the machines that are located in commercial and charitable establishments.

In March 2008, the Maryland Attorney General's Office issued two separate letters providing advice regarding the use of certain types of gaming machines in St. Mary's

County and if paying off on free play is illegal gaming, respectively. In the latter, paying off on free play was viewed to be illegal gaming.

In the former, the Attorney General's Office advised that instant bingo machines containing pre-printed tickets or pull-tab in a predetermined order are legal under certain circumstances. However, among other factors considered with respect to the legality of the St. Mary's County gaming machines, the Attorney General's Office found cartridge machines, which contain a computer chip with preprogrammed outcomes, illegal. *The Washington Post* reports that the St. Mary's County Sheriff's Department subsequently found every business operating gaming machines to be noncompliant in at least one area (e.g., establishment owners in addition to qualified organizations were profiting, qualifying organizations were not personally managing the "gaming event"). The sheriff's office has since informed businesses that illegal machines must be removed voluntarily or otherwise.

However, on May 5, 2008, St. Mary's Circuit Court issued a ruling that cartridge machines are legal under current law. According to the *Washington Post*, the St. Mary's County Sheriff expects some machines that had been put in storage voluntarily or seized since March to return to service as a result of the court's decision.

As reported in the *Washington Post*, video gaming devices, which look like slot machines, recently proliferated across St. Mary's County. The gaming devices operate out of restaurants, taverns, bingo parlors, and social/fraternal organizations, while simultaneously being managed by a sponsoring not-for-profit organization. The not-for-profit organizations • collect the proceeds; • remit approximately 60% of the proceeds to the gaming company that owns the machines (e.g., Frank Moran and Sons); • keep between 30% and 35% of the money; and • then provide 5% to 10% to the retail facilities in which the gaming devices are kept.

The St. Mary's County Treasurer and Finance Department indicate that the county is not collecting various revenues from the gaming devices. The St. Mary's County Treasurer indicates no personal property taxes are being collected, which indicates operation of the machines occurs under a leasing arrangement. The St. Mary's County Finance Department advises that its current understanding is that a portion of the local admissions and amusement tax will be reimbursed to the county once initial distributions occur.

The State Lottery Agency is currently monitoring product sales in St. Mary's County, since gaming devices began to proliferate in December 2007. Prior to December 2007, lottery sales in St. Mary's County were up 9.23%. Since December 2007, lottery sales in the county have dropped 5.35%. Significant declines are being reported in facilities that sell both lottery products and provide gaming devices: weekly lottery sales in one

St. Mary's retail location that contains approximately 35 gaming devices have declined 28% (from \$61,596 down to \$44,089 per week).

Washington County

Washington County indicates there are two types of electric tip jar devices in the county: 26 tip jar dispensing machines, which the county advises are legal under the bill's provisions, and only one electronic gaming device containing a roll of 7,000 pre-printed tip jar tickets that Washington County advises the business owner intends to phase out of operation. The county advises that the 26 dispensing machines were purchased at a cost of approximately \$3,000 per machine; thus small businesses and clubs in the county have invested approximately \$78,000 in capital equipment.

According to the Washington County Gaming Office, a tip jar dispensing machine is a tip jar ticket vending machine. The operator loads traditional pre-printed tip jar tickets into the machine. The customer looks through the windows of the machine and sees a ticket they wish to purchase. The customer then inserts money into the bill acceptor and pushes a button beneath the ticket to be purchased. The ticket falls out of the machine into a tray. The customer then opens the ticket to determine if he is a winner or loser. If a winning ticket is purchased, the ticket is then redeemed by a clerk. The tickets this machine dispenses may also be taken from the machine and sold in a person-to-person manner.

Washington County charitable gaming proceeds come from three sources: not-for-profit organizations, for-profit businesses, and charitable organizations (*e.g.*, fire and rescue organizations), as presented in **Exhibit 6** for fiscal 2007.

Exhibit 6
Fiscal 2007 Washington County Net Profits
(\$ in Millions)

	<u>Not-for-profit</u>	<u>For-profit</u>	<u>Charitable</u>	<u>Total</u>
Gross Revenues	\$42.3	\$21.8	\$7.6	\$71.7
Winners	35.5	18.0	5.9	59.4
County Proceeds	1.0	1.9		2.9
Direct Expenses	<u>1.0</u>	<u>0.5</u>	<u>0.2</u>	<u>1.7</u>
Net Profit	4.8	1.3	1.5	7.6

Note: Totals may not equal due to rounding.

Legislative Services notes that the pull-tab gaming market in Washington County totals approximately \$71.7 million a year.

Market Development

A prime intention of gaming suppliers is to maintain a controlled player interface (that is, what the player sees), while maintaining flexibility to change the internal platforms unseen by the player. Developers of gaming and gambling platforms take great care to ensure players' interface with games are identical in outward appearance. The greatest changes occur with the internal platforms used to support gaming. The platforms, inside the machine or system, provide the delivery mechanism by which a player's experience is maintained with the intention of delivering a consistent experience for the player.

Through technological advancements, traditional Internet gaming providers (*e.g.*, Boss Media) are investing in the gambling market and many system platforms now use the latest microprocessor-based technology. Likewise, traditional gaming machine vendors are merging with the online technologies to leverage and enhance player experience. With a focus on younger demographics, gaming interests are developing intense, vivid graphics, as well as multi-player games.

State Revenues: Based on initial collections data, the Comptroller has estimated annual admissions and amusement tax revenues of approximately \$5.0 million from electronic gaming machines. General fund revenues, therefore, could decrease by an estimated \$5.0 million on an annual basis beginning in fiscal 2010 when most existing machines will be prohibited. Revenues could decrease in fiscal 2009 when the bill takes effect, but the amount depends on the number of machines in operation that become illegal on July 1, 2008, and is therefore indeterminate.

However, general fund revenues could increase from increased lottery sales. The increase cannot be quantified at the time. Based on the experience of lottery sales in St. Mary's County, where since December 2007 lottery sales have dropped 5.35%, revenues associated with lottery sales would likely increase in counties where the electronic gaming devices will be prohibited.

Local Fiscal Effect: Loss of local admissions and amusement tax revenues. During the 2008 session, Allegany County has provided three revenue loss estimates: over \$30,000; \$205,000; and approximately \$500,000 per annum. With respect to Anne Arundel County, revenue losses from the phase out of Anne Arundel County bingo hall machines are expected to be approximately \$2.0 million per annum. Other counties and municipal

corporation revenues, primarily in Calvert and St. Mary's counties, would be affected but cannot be reliably estimated at this time.

Small Business Effect: Overall minimal; however, to the extent small businesses have undertaken capital investments or lease and operate slot machines, as defined under the bill, revenues will decline.

Additional Information

Prior Introductions: None.

Cross File: HB 1576 is identified as a cross file but is different.

Information Source(s): Boss Media, Entropia Universe, State Department of Assessments and Taxation, Secretary of State, City of College Park, Allegany County, Montgomery County, Prince George's County, St. Mary's County, Talbot County, Calvert County, Charles County, Maryland State Lottery Agency, Comptroller's Office, Department of State Police, Maryland Association of Counties, Baltimore City, Technical Systems Testing, *Washington Post*, Department of Legislative Services

Fiscal Note History: First Reader - March 5, 2008
ncs/rhh Revised - Senate Third Reader - March 27, 2008
Revised - Enrolled Bill - May 20, 2008
Revised - Correction - June 16, 2008

Analysis by: Michael P. Lee

Direct Inquiries to:
(410) 946-5510
(301) 970-5510