

TAVERN GAMING: CALENDAR YEAR 2022



May 2023

TO: Members of the Legislative Budget and Finance Committee

FROM: Christopher C. Latta, 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, an amendment to the Local Option Small Games of Chance Act, authorized small games of chance in Pennsylvania's taverns. It also directs the Legislative Budget and Finance Committee 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 (LBFC) 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 eighth report under this mandate.

The Impact of Tavern Gaming on the State Lottery¹

When the General Assembly debated Act 2013-90, the Governor's Office of the Budget estimated 2,000 establishments would be licensed, generating an average weekly payout of \$10,000 per license. Using this as-

¹ 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 state Commonwealth Court dismissed the claim ruling that the state lottery's Internet-based games do not infringe on the casinos' online games market. The case has been appealed to the Pennsylvania Supreme Court. In August 2022, the Supreme Court approved oral arguments on the case, which await scheduling. Additionally, following inquiries from two state lotteries, the DOJ issued an opinion in 2011 stating the Wire Act of 1961 did not apply to interstate transmissions of wire communications that do not relate to a "sporting event or contest" (sports betting), allowing for online lottery games and casino gaming. The 2011 DOJ Opinion was relied upon by many states, including Pennsylvania, for the implementation of their iLottery programs and Pennsylvania online casino gaming. However, in 2018, the DOJ reversed its position and issued an opinion that reapplied the Wire Act beyond sports betting. A lawsuit was filed against the DOJ's 2018 opinion, and the US District Court of New Hampshire ruled the 2018 DOJ Opinion was invalid. The DOJ appealed this decision and in January 2021, the First Circuit Court of Appeals upheld the lower court's decision; therefore the 2011 DOJ opinion remains valid.

sumption, tavern gaming was estimated to generate total annual net revenue of \$156 million, which would generate (at a 60 percent tax rate) \$93.6 million in additional revenues for the General Fund annually.

However, actual tavern gaming tax revenues have been far lower than initially projected. In CY 2014, tavern games generated approximately \$153,000 in tax revenue. Revenues had increased in successive years until CY 2019 when there was a 19 percent decrease in tax revenues from the prior calendar year. There was a further decrease of 38 percent from CY 2019 to CY 2020 with revenues of \$1.37 million in tavern games and host municipality tax revenue in CY 2019 and only \$856,538 in CY 2020.² Tavern tax revenues rebounded in CY 2021, increasing 48 percent from CY 2020. In CY 2022, revenue dropped slightly from CY 2021. Exhibit 1 shows these tax revenues for CYs 2018-2022 and Lottery revenues for the same period.^{3,4} For CY 2022, tavern game tax revenues were 0.07 percent of Lottery revenues.

Exhibit 1

Tavern Games Tax and Lottery Revenue* (CY 2018-2022)

<u>Calendar Year</u>	<u>Tavern Games Revenue</u>	<u>Lottery Revenue</u>	<u>Tavern Tax Revenue to Lottery (%)</u>
2018	\$1,638,406	\$1,564,421,796	0.10
2019	1,374,100	1,595,846,207	0.09
2020	856,538	1,717,515,454	0.05
2021	1,266,131	1,864,127,740	0.07
2022	1,182,100	1,736,736,087	0.07
TOTAL	\$6,317,275	\$8,478,647,284	

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.

² We reason that tavern revenue was lower in CY 2020 because of COVID-19; taverns were shut down several times throughout CY 2020 and therefore did not operate normally.

³ Lottery revenue figures are total sales minus prize liability for all lottery games, including iLottery games. Tavern revenues are total sales minus prize liability, minus the 35 percent that tavern licensees may keep as revenue.

⁴ In 2017, Act 2017-42 authorized iLottery, which 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."

The \$1.27 in tavern game and host municipality tax revenue collected in CY 2021 represents about \$1.95 million in patron losses, compared to about \$1.86 billion in patron losses for persons participating in Lottery games that year, as shown in Exhibit 2. Tavern gaming patron losses were one-tenth of one percent (0.10 percent) of the losses incurred by those playing Lottery games. For CY 2022, this number remained at 0.10 percent, with lottery patron losses at \$1.74 billion and tavern games patron losses at \$1.82 million. This ratio has remained relatively steady from CY 2018 to CY 2022, ranging from 0.08 to 0.16 percent.

Exhibit 2

Ratio of Lottery Patron Losses to Tavern Game Patron Losses (CY 2018-2022)

<u>Calendar Year</u>	<u>Lottery Patron Losses</u>	<u>Tavern Game Patron Losses</u>	<u>Tavern Games to Lottery (%)</u>
2018	\$1,564,421,796	\$2,520,624	0.16
2019	1,595,846,207	2,114,001	0.13
2020	1,717,515,454	1,317,751	0.08
2021	1,864,127,740	1,947,894	0.10
2022	1,736,736,087	1,818,615	0.10

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

Because tavern gaming losses were low compared to lottery losses and have remained consistent since we began 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 from 0.05 to 0.10 percent of lottery revenues for the past five years.

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 to determine whether to award a license. The report includes information to determine if the applicant is financially stable and

responsible, has sufficient business experience, could 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 February 2023, the PLCB has approved 77 tavern gaming licenses from the 94 applications it has received; 41 licenses are active, four fewer than noted in our last report, and 29 licenses have expired, seven more than in our previous report.

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 act's provisions relating to enforcement and tax collections.

Cost to Applicants

To apply for a license, individuals must submit \$2,000 to the PLCB (\$1,000 is for an application fee to the PLCB and a \$1,000 investigation fee is forwarded to the PGCB) with a completed application packet. If an application is approved, the licensee must pay an additional \$500 license fee.⁵ 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 background investigation costs exceed the fee, the applicant must pay all additional charges. The PLCB retains the \$1,000 licensing fee to cover its administrative costs.

Pennsylvania Costs to Administer Tavern Games

The costs to administer tavern gaming are minimal for the three Pennsylvania agencies tasked with tavern game administration, the PLCB, DOR, and the PGCB. PLCB estimates \$36 per application in personnel costs, resulting in a net gain from the \$1000 in application fees received by the agency. Although the DOR does not receive any part of applicants' fees, it estimates its costs to be \$1157 annually, based on 31 hours of work. Total costs in CY 2022 for the PLCB to process applications and for DOR to administer tavern gaming were about \$1,300.

The PGCB indicated the precise costs to perform individual background checks for tavern gaming licenses vary based on factors including the

⁵ The additional license fee was originally \$2,000. This was lowered by the PLCB to \$500 in July 2014.

scope of the investigation, the size and number of persons and entities in the ownership of an applicant, and the history and nature of any tax, criminal, civil, or other regulatory matters. The individualized nature of the investigations precludes a generalized determination of costs that would apply across the board to all applicants. However, the PGCB believes that its costs to perform these checks are appropriately offset by the \$1000 fee.

Allowable Tavern Games

Under Act 90, tavern owners may sell various games, including pull-tab games, daily drawings, and raffles at licensed establishments. The act defines pull tabs 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, and 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 number of prizes payable by a licensee from a tavern game.

Raffles, which may only be held for a charitable or public interest purpose, may be held no more than once in a calendar month.⁶ 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 according to the same 60/35/5 split as defined above.

⁶ 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).