# THE AGONY AND THE ECSTASY OF NEVADA'S GROSS REVENUE LICENSE FEE

**By Maren Parry, Esq.**

The Nevada tax that claims a share of every dollar won by the state's casinos celebrated its 60th birthday in 2005. On the surface, its history has been one of ecstasy for residents who enjoy better schools, highways, and public services funded by its proceeds, but pay lower personal taxes. What is not immediately evident is the agony of continual administrative, legislative and judicial disputes between the state regulators charged with collecting the tax, and the casinos that are required to pay it. To truly appreciate the success of the tax statute, one must first be introduced to the agony associated with maintaining the integrity and spirit of a fundamental law in the face of a rapidly changing gaming world.

Although Nevada legalized gambling in 1931, no effort was made to directly tax casinos until 14 years later. From legalization until 1945, a potential casino owner needed only to obtain a license from the appropriate town, city or county in which the business was located, and pay the license fees of $25 per month for each table game and $10 per month for each slot machine.[1] These license fees were then apportioned among the state, county, and city or town where the gaming activity took place.[2] The state's budget was not dependent on the revenues generated by the legalized gaming activity and the regulation of gaming was left to city and county officials.[3] The Legislature soon began to realize that poor enforcement of local licensing also meant poor collection of the fixed licensing fees, and as a result, less tax revenue for the state. In 1937, the Legislature passed a resolution chastising local law enforcement for its "deplorable lack of enforcement" of licensing laws, and directed Nevada's Attorney General to urge the law's enforcement.[4]

In 1945, lawmakers recognized the untapped potential in gaming taxes and created a state casino license. The industry's state regulatory scheme was devised as an experiment to find more money for the state budget by a few members of the 1945 State Legislature while dining at a café in Carson City.[5] The idea was introduced as Senate Bill 142, and the monumental bill made the Nevada Tax Commission the gaming industry's regulatory authority.[6] At that point, the State was only interested in collecting taxes,

and the actual regulation of gaming activity remained in the hands of the local authorities. Set originally at only 1% of a licensee's gross revenue exceeding $3,000.00 quarterly, the tax made a relatively small impact and only generated about $100,000.00, a drop in the bucket of the state's total budget.[7]

But not everyone had confidence in the novel taxation experiment. The drastic change in the method of taxing Nevada's unique industry prompted then Governor E.P. Carville to include a warning with his transmission of Senate Bill 142 to the Secretary of State after the constitutional time limit for acting on the Bill had lapsed, allowing the bill to become law without his signature.

He warned:

> Senate Bill No. 142 imposes on the gambling business a type of tax which the State of Nevada has avoided in the past as a matter of policy. It has been strenuously argued that the gambling business is in an entirely different category from what we may, for the mere sake of differentiation, term legitimate business.
>
> I feel, however, that with the State making this departure from its fixed past policy, the effort will be made to extend the imposition of this type of taxation, and the wiser course would have been to avoid this type of taxation, and obtain a just contribution from the gambling business by imposing a higher license fee.[8]

The 1945 act defined "Gross revenue" in one sentence: "The total of all sums received as winnings less only the total of all sums paid out as losses by a licensee under a state gambling license. . . ."[9] This calls for a simple calculation process. The casino counts its bankroll at the beginning and end of the tax period and pays a percentage license fee on the increase, if any. No deductions are allowed for operating expenses, payroll, or mortgage interest.[10] In the last 60 years, this definition has been painstakingly expanded into almost a full page of text, but it has retained its original scope and intent: a percentage tax[11] on net cash winnings.[12] Records of state regulatory agencies (the Nevada Gaming Control Board and the Nevada Gaming Commission), courts and the Legislature provide a chronology of this expansion resulting from disputes between state government and casinos over what exactly is subject to the tax, and an amazing picture of how adding words doesn't always equate to added meaning.

In 1946, Robbins Cahill, head of the newly created Gaming Division of the Nevada Tax Commission, tested the new state regulatory scheme by telephoning the infamous "Bugsy" Siegel and demanding payment of the operation's one percent gaming tax. Cahill lived to tell this story, but realized that his threat to revoke Siegel's gaming license in response to Bugsy's question, "What'll you do if I don't pay?" was only a bluff.[13] In the early years, the Tax Commission had no authority or mechanism to exclude unsavory characters from the

licensing process, or to revoke a gaming license once it had been issued.[14] This posed an enforcement problem for the Commission because unsavory characters may be prone to cheat on their taxes. Plus, if patrons don't trust the games because they do not trust the person by whom they are administered, there may be less play and fewer taxes to collect.

In 1947, Mr. Cahill took Bugsy's question to Attorney General Alan Bible. The answer, in the form of an Attorney General's Opinion, established the foundation for the creation of the State Gaming Control Board in 1955:

> "Specifically, we are of the opinion that your commission may adopt and administer rules and regulations concerning the issuance and continued possession of a gaming license, requiring, among other things, . . . Inquiry into the "antecedents, habits and characters" of applicants in order to satisfy the commission that they will not violate the gambling law. . . . If on such inquiry your board finds reasonable ground to apprehend that the grant of a license would be against the public interest, you would be within the powers delegated to you to refuse a license."[15]

The Board was charged with the investigation of applications and enforcement duties, and reported on applications for gaming licenses to the Tax Commission for final approval.[16]

When Governor Grant Sawyer took office in 1959 after winning the election on the slogan "Nevada is not for sale," he set out to rid the State's most important industry of its notorious reputation as a haven for mobsters and criminals.[17] The first bill he signed in office created the Gaming Control Act, which vested the primary control of the gaming industry in a new, independent agency, the Nevada Gaming Commission.[18] This Act provided the framework for the current two-tiered regulatory system which is still in place today, and which has been copied in emerging gaming jurisdictions throughout the world. Despite this shift in the focus of gaming regulation from tax collection to suitability of licensees, the simple, one-sentence definition of gross revenue remained.

While a change in regulatory structure did not prompt a revisit to the definition of "gross revenue," an important trend in the method of play within the gaming industry brought the statute's interpretation under scrutiny. Big players could now wager and lose millions of dollars on a credit basis, and the account could be settled and the debt collected later. The Gaming Control Board began tracking credit play activity, and developed tax-reporting forms which arrived at a licensee's net cash winnings by adding credit issued, and deducting unpaid credit instruments.[19] When regulators observed that 26% of the total volume of play in Nevada was on credit, and that $55 million in credit was left uncollected, they quickly equated credit play with cash play, and viewed this failure to collect as a loss to the State of approximately $3 million in tax revenue.[20]

In response, auditors with the Board began subtly pushing toward the accrual method of accounting and away from the cash basis by discretely expanding the definition of gross revenue and assessing taxes against certain markers for insufficient collection activity. Eventually, the chief of the Board's Audit Division incorporated this accrual method of calculating gaming taxes into an audit manual. Neither the Commission nor the Board adopted this manual, and licensees did not have access to it. The licensee's taxes, however, were calculated according to the methods set forth in the manual's pages. Licensees complied for some time, noting that the legal fees and court costs would most likely exceed the taxes assessed.[21]

The Board approached the Legislature with a proposition that its assessment technique be given statutory authority in 1977, but its suggested legislation was never proposed as law. The industry then determined that it would no longer pay the assessments after being advised by counsel that there was no statutory provision requiring licensees to do so.[22] In 1979, the Desert Inn was assessed additional license fees on uncollected markers after an audit by the Board.[23] Under the statutes and regulations, uncollected markers were to be excluded from quarterly winnings in determining tax liability. The Board, however, assessed a tax on those markers, which it deemed "irregular" for various reasons.[24] This issue was finally placed before the court, which determined what the statute had said all along: sums received as winnings refers to cash taken in by the licensee, and that a cash basis of accounting is appropriate for the analysis. The Board did not have the power to regulate markers through punitive taxation.[25] The opinion was affirmed by the Nevada Supreme Court in 1982, but the decision was issued after the Legislature had already addressed the issue by revising the provisions dictating the computation of gross revenue during the 1981 legislative session.[26] Bills addressing the controversy were proposed by both the regulators and the regulated, and an extensive legislative history provides the testimony and reasoning of the advocates. Also referenced in this history are unrecorded meetings among the prominent players negotiating a compromise between various versions of proposed bills. Though no stenographer was present, the compromise drafts emerging from these meetings allude to the give and take that must certainly have occurred.[27] At the end of the day, both sides took their seats exhausted, but at least partially satisfied. The industry retained its cash basis of accounting and went home vindicated. The regulators accepted that it could not "tax" irregular markers, but the amendment created a penalty on irregular markers, which just so happened to be equal to the amount that the state *would* have received in gross revenue taxes had such markers been collected.[28]

After the 1981 amendment addressed the idea of deductions, questions about the permissibility of various deductions from gross gaming revenue emerged with respect to a variety of expenses. In a world of IRS accrual accounting, it seemed as though there *must* be certain legitimate deductions from the tax basis. First, the statute was clarified in 1985 to state that amounts paid out to purchase annuities, which represent deferred payment of winnings to patrons were acceptable subtractions from the gross revenue totals.[29] A few years later in 1987, the list of what gross revenue did *not* include received a statutory section of its own, including counterfeit[30] or foreign coins, cash taken in un-reimbursed fraudulent acts, and cash received as entry fees for contests or tournaments in which patrons compete for prizes.[31] Once the smoke cleared, the Legislature had again clarified that the items included on this list really weren't deductions at all, because none of them had been taken in as winnings in the first place.

In addition to starting the laundry list of items, which do not constitute gross revenue, 1985 brought the second major wave in the Legislature's discussion of the license fee. Harrah's had recently challenged a decision by the Board which taxed the value of prizes paid

out to patrons as winnings, but allowed the deduction of cash paid out as winnings from the calculation of gross revenue. The question reached the Nevada Supreme Court in 1983, which ruled that there is an important distinction between merchandise "lost" as a result of a legitimate wager, and merchandise "given away" to promote gaming at a the licensee's establishment.[32] Merchandise in the first category was considered a loss under the meaning of the statute, and was thus deductible, while merchandise in the second category was deemed an advertising-like cost of doing business, and was not deductible. Again, the Legislature was lobbied to clarify the issue, and representatives of the regulators and the regulated agonized over the interpretation of the statute. Licensees reasoned that they needed to keep up with the evolving market and find new and exciting ways to attract customers. Variety in the way that losses could be paid out to patrons would allow creative and inventive marketing strategies, and allow smaller licensees to compete with the larger players by providing unique winnings, without sacrificing the reduction of their tax liabilities in return. A representative of Harrah's, Sam McMullen, pointed out that the licensees were not attempting to increase the amount of money that they could pay out to patrons. Instead, the more excitement generated by the variety of pay-outs, the more money patrons spend, and the more gross revenue fees collected by the state.[33]

Hot topics in the discussions included the method of determining the value of the prizes paid out, and how the Board would audit the pay-out of the prizes. The bill, which was ultimately enacted reflected several compromises to address these concerns. Only the actual cost to the licensee of personal property distributed would qualify for the deduction. Items with values difficult to ascertain, such as travel expenses, food, refreshments, lodging, or services (often referred to as "comps"), were specifically excluded. In response to concerns about the scope of the statute and its fiscal impact, the bill was limited to slot machines, and a sunset provision would return the statute to its original form in 1987. When the concerns about the potential loss of revenue to the state proved to be unfounded, the gaming industry and the Board both supported a repeal of the sunset provision in 1987, and this marketing technique remains popular today.[34]

Expanding on the marketing strategies, which had brought success through variety and creativity, licensees began offering promotional chips to prime the pump of player activity. The Golden Nugget, for example, issued one 50 cent ticket for every $75.00 wagered-regardless of gains or losses-to patrons enrolled in the "24 Karat Club." Tickets could be traded for "Gold Certificates," which could in turn be redeemed for gaming tokens, cash, room rental, food, beverages or merchandise.[35] When the Golden Nugget sought to exclude 50 cents per ticket issued from its gross revenue computation as a loss paid out to patrons, the Board disagreed and assessed the tax. The Nevada Supreme Court ultimately agreed with the Board and issued its decision that the 50 cent ticket did not constitute a loss which could be excluded from the computation of gross revenue, because the 50 cent ticket was not "won" by the patron as the result of a legitimate wager between the patron and the licensee.[36] The licensee had to accept that this


type of perk was a cost of doing business, just as if it were handing out a lollipop to encourage each pull on the slot machine.

But what happened when a player chose to play with the 50 cent ticket instead of trading it in for food or merchandise? The casino received no cash in exchange for the ticket, and its return to the casino did not create an increase in the licensee's gross revenue. Representatives of the gaming industry again approached the Legislature to clarify that licensees would not be required to pay a tax on promotional chips eventually ending up back in the cage. Although this made perfect sense under a gross revenue system, regulators also noticed the flip side of the coin. For example, say that a casino issues a $100 chip to a patron to promote play. If the player puts the chip down on the blackjack table and loses it in the first hand, the casino hasn't "won" anything. No tax is paid on the value of the chip, but the player stays at the table and any money subsequently won by the casino is taxed as gross revenue. Everyone agreed that this result was appropriate. On the other hand, if the player placed a bet with the $100 chip and won $1000, the casino had to pay that money to the patron. The casino's tax liability would in turn be reduced by $1000, and the regulators saw the opportunity to collect the resulting sixty dollars slipping away.

After extensive debate and extreme mental gymnastics, the Legislature concluded that a casino would never give away promotional chips knowing that they would be converted into cash for the patron's use somewhere outside the property. Nor, for that matter, would a casino pay out $1000.00 for the opportunity to reduce its overall tax liability by about sixty dollars.[37] To account for the promotional play, the list of deductions from the computation of gross revenue was expanded to include "Any portion of the face value of any chip, token, or other representative of value won by a licensee from a patron for which the licensee can demonstrate that it or its affiliate has not received cash."[38]

The issue reappeared in 1997 when the Board approached the Legislature for a clarification of the policy behind the 1995 amendment. The Board believed that the deduction from gross revenue applied only to chips which were negotiable and could either be wagered or redeemed for cash, while the industry asserted that the deduction applied to negotiable and non-negotiable chips alike. The Board's reasoning was that a non-negotiable promotional chip was not a "representative of value" because it could only be used for play at the gaming property and had no value beyond the premises. Play with such chips could not constitute a "wager" because the patron did not risk anything, and as a result, any money paid out by the licensee could not constitute a "loss" to be deducted for purposes of calculating gross revenue.[39] By adding the definition that "'Representative of value' means any instrumentality used by a patron in a game whether or not the instrumentality may be redeemed for cash," and that "'Wager' means a sum of money or representative of value that is risked on an occurrence for which the outcome is uncertain," the Legislature agreed with the industry and avoided a result that would have gone against the spirit of the law.[40]

Despite 60 years of discussion and several pages of amendments, the gross revenue license fee concept remains the same as was adopted in one sentence in 1945: Cash in Cash out = Gross Gaming Revenue. Every action taken by the Legislature has been only a clarification at the request of the regulators or the regulated to assist in the interpretation of a simple concept in a complex world. The relative quiet since 1997 may indicate that the agony associated with understanding and applying the net cash policy of the gross revenue license fee is permanently in the past as a result of adding experienced practical leadership to the already impressive Gaming Control

Board and Commission membership.

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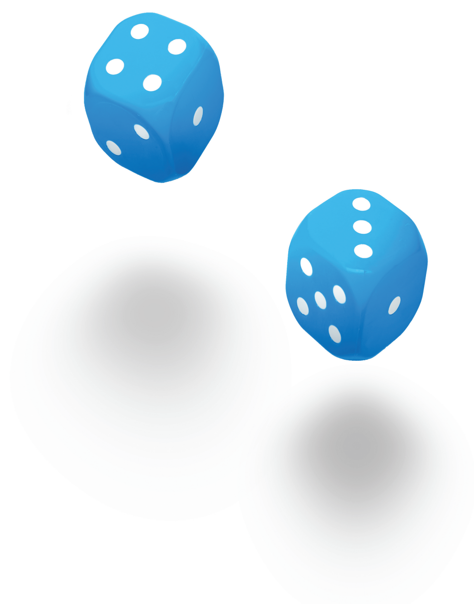

[1]Lionel, Sawyer & Collins, Nevada Gaming Law 10-11 (3rd ed. 2000).

[2]Id. at 11.

[3]Id. at 12.

[4]Id.

[5]Ed Vogel, Nevada Appeal, *First Gaming Regulator Looks Back with Amusement*, Nevada Appeal, June 11, 1990 at A1, A10.

[6]S.B. 142, 1945 Leg., 42nd Reg. Sess. (Nev. 1945).

[7]Lionel, Sawyer & Collins, Supra note 1, at 12. Not a lot compared to the $790,403,819 collected in 2006. Nevada Gaming Commission and Gaming Control Board Information Sheet, Gaming Taxes and Fees: Collections by Category *at* http://gaming.nv.gov/gamefact06.htm (last visited July 17, 2007).

[8]Note to Secretary of State Malcolm McEachin, March 28, 1945, included with S.B. 142, supra note 6.

[9]Nev. S.B. 142 supra note 6.

[10]NOTE: for those of us that are math challenged and scared of anything that involves taxes: Winnings - Losses = Gross Revenue. To truly understand the gross revenue license fee, check any Internal Revenue Service tax preparation knowledge at the door.

[11]The scope and intent of the fee have remained the same, but the tax rate has been adjusted occasionally. It is currently calculated on a graduated scale, as follows:
(a) Three and one-half percent of all the gross revenue of the licensee which does not exceed $50,000 per calendar month;
(b) Four and one-half percent of all the gross revenue of the licensee which exceeds $50,000 per calendar month and does not exceed $134,000 per calendar month; and
(c) Six and three-quarters percent of all the gross revenue of the licensee which exceeds $134,000 per calendar month. Nev. Rev. Stat. 463.370 (2005).

[12]The current gross revenue system is detailed in Nev. Rev. Stat. 463.0161 and 463.370-2 (2005). The reader is directed to those citations as the footnote giving them in full was over a page long, in very small font.

[13]Vogel, supra note 5, at A1.
[14]Id.

[15]GAMBLING State license necessary requisite to obtain county license Tax commission may exercise discretion in issuing licenses. Op. Att'y Gen. No. 47-528 (October 14, 1947).

[16]Lionel, Sawyer & Collins, supra note 1, at 19.

[17]Sawyer's mandate for the new Commission was that: "Exhaustive investigations (must) be made as to present licensees in order to be as certain as humanly possible that criminal elements, mobs, or syndicates have neither interests nor control of existing businesses." Id. at 23.

[18]Id. at 22-23.

[19]Robert D. Faiss, *Gaming Regulation and Gaming Law in Nevada*, 29-30 (R. T. King ed., U. of Nev. Oral Hist. Prog. 2005) [hereinafter Faiss, *Gaming Regulation and Gaming Law in Nevada*].

[20]*An Act relating to gaming; revision provisions on the computations of gross revenue; and providing other matters properly relating thereto: Hearing on S.B. 320 Before the Joint Senate and Assembly Comm. on Judiciary*, April 14, 1981, 1981 Leg., 61st Sess. 2 (Nev. 1981) [hereinafter *Hearing on S.B. 320* (April 14, 1981)] (statements of Carl Dodge, Chairman, Nevada Gaming Commission).

[21]Faiss, *Gaming Regulation and Gaming Law in Nevada*, supra note 20, at 30-31.

[22]*Hearing on S.B. 320* (April 14, 1981), supra. note 19, at 7-9 (statements of Robert D. Faiss, Attorney, Nevada Resort Association).

[23]Summa Corp. v. State Gaming Control Bd., No. A189417, slip op. at 2 (Eighth Jud. Dist. Ct. Dec. 29, 1980).

[24]The court defined "Irregular markers" as "gaming credit

instruments issued either improvidently or improperly, i.e., in violation of Regulations or accepted internal controls." Id. at 2 n. 2. Examples include credit instruments which were not signed or acknowledged by the patron, and markers for which the licensee cannot provide evidence that it has made reasonable efforts to collect the debt. Id. at 4-6.

[25] Id. at 7.

[26] S.B. 320, 1980 Leg., 61st Reg. Sess. (Nev. 1981).

[27] See *Hearing on S.B. 320* (April 14, 1981), supra., note 19; *An Act relating to gaming; revision provisions on the computations of gross revenue; and providing other matters properly relating thereto: Hearing on S.B. 320 Before the Joint Senate and Assembly Comm. on Judiciary*, May 6, 1981, 1981 Leg., 61st Sess. (Nev. 1981).

[28] Surprisingly, an almost identical issue resurfaced just a few years later when the Gaming Control Board began assessing taxes on unpaid Baccarat commissions. In 1993 an amendment was added clarifying that if the licensee never collected the commission, it was not cash in, and thus not taxed as gross revenue. A.B. 230, 1993 Leg., 67th Reg. Sess. (Nev. 1993).

[29] S.B. 269, 1985 Leg., 63rd Sess. (Nev. 1985). For the record, this was again expanded in 1995 to include periodic payments of winnings and payments made in inter-casino linked systems. A.B. 131, 1995 Leg., 68th Reg. Sess. (Nev. 1995).

[30] The definition of what constitutes a "counterfeit" was again expanded in 1995 to take into account facsimiles of all sorts of wagering instruments, including those used in cashless wagering systems. S.B. 401, 1995 Leg, 68th Reg. Sess. (Nev. 1995).

[31] S.B. 550, 1987 Leg., 64th Reg. Sess. (Nev.1987).

[32] Harrah's Club v. State, 659 P.2d 883 (Nev.1983).

[33] *An Act relating to gaming; revision provisions on the computations of gross revenue; and providing other matters properly relating thereto: Hearing on S.B. 380 Before the Senate Comm. on Judiciary*, May 2, 198, 1985 Leg., 63rd Reg. Sess. 5-7 (NV 1985).

[34] *An Act relating to gaming; repealing prospective changes to provisions governing the calculation of gross revenue of a gaming licensee; and providing other matters properly relating thereto: Hearing on A.B. 125 Before the Senate Comm. on Judiciary*, March 11, 1987, 1987 Leg., 64th Reg. Sess. 1-2 (NV 1987).

[35] Gaming Comm'n v. GNLV Corp., 108 Nev. 456, 457 (Nev., 1992).

[36] Id. at 457-8.

[37] *An Act relating to gaming; an act clarifying the term "gross revenue"; and providing other matters properly relating thereto: Hearing on S.B. 399 Before the Senate Comm. on Judiciary*, May 18, 1995, 1995 Leg., 68th Reg. Sess. (NV 1995).

[38] S.B. 399, 1995 Leg., 68th Reg. Sess. (Nev.1995).

[39] *An Act relating to gaming; making changes to the provisions governing the regulation of gaming; and providing other matters properly relating thereto: Hearing on A.B. 419 Before the Senate Comm. on Judiciary*, June 25, 1997, 1997 Leg., 69th Reg. Sess. (NV 1997).

[40] A.B. 419, 1997 Leg., 69th Reg. Sess. (Nev.1997).