

# NEW REMEDIES FOR AN EVIL ECONOMY: FORECASTING U.S. TAX POLICY FOR GAMING

By Peter J. Kulick



It was Francis Bacon who observed centuries ago, "He that will not apply new remedies must expect new evils, for time is the greatest innovator." The year 2008 saw the United States and much of the rest of the world enter the throes of an economic meltdown. 2008 was also a presidential election year in the United States. The economic malaise, coupled with the fickle fatigue of the American electorate for a political party that had held power for eight years, ushered Barack Obama into the White House and gave Democrats a stranglehold control of Congress. Two short years later, with sky-high unemployment and an economy struggling to emerge from a recession, the American electorate dramatically changed directions. The 2010 mid-term elections were marked by gains of historic proportions, giving the Grand Old Party control of not only the U.S. House of Representatives by flipping more than 63 House seats to the GOP column, but also narrowing the gap in the U.S. Senate by picking up six seats (including Barack Obama's old Illinois Senate seat), as well as catapulting Republicans to control of several state legislative houses.

The past two years have been witness to the efforts of Democrats to introduce watershed policies, particularly in the area of tax policy. These efforts have included several strongly anti-business international tax proposals and the enactment of significant healthcare legislation that included several new tax law provisions. Additionally, Congress has also adopted less controversial tax law measures that were aimed to stimulate economic activity. These less controversial measures include payroll tax incentives intended to encourage the hiring of unemployed workers and the introduction of several new tax exempt bond provisions to facilitate access to the then-frozen credit markets.

The gaming industry has not been immune to the economic meltdown of the past two years. In contrast to prior recessions, the gaming industry has experienced steep drops in gaming revenue in several key jurisdictions, including the Las Vegas Strip,

Atlantic City, Indian country and the important overseas market of Macau. As gaming revenue declined, rack rates on the Las Vegas Strip also dropped sharply, as did revenue from ancillary entertainment. This impact reverberated to suppliers, including gaming equipment manufacturers and other casino vendors. While there may have been initial surprise within the industry about the impact of the economic meltdown on gaming, in hindsight, the consequences may not be all that surprising—particularly in light of the rapid expansion of the gaming industry throughout the United States and the evolution of the industry to control by multinational businesses.

Casinos generated approximately \$31 billion in gaming revenue in the United States in 2009. As a result, tax policy and other legislative initiatives adopted in Washington, D.C., and in the various state legislative chambers will have an impact on the industry. As the Republican party assumes the majority in the U.S. House during the next Congress, the U.S. can expect that new remedies will be offered to combat stagnant job growth and tepid economic activity. Similarly, the election of Republican majorities in several of the state legislative houses will also bring new policy remedies. Predicting the future requires an examination of where we have been. With a background of the policies adopted during the past two years, predications of what can be expected in 2011 can be offered.

## 2008: Where We Were and Policies Advanced

The hallmark of the economic and tax policies advanced during the past two years has been a push for a greater governmental role in the markets. During the lame duck session of Congress in 2008, the first economic stimulus package was passed. Shortly after Obama assumed the U.S. presidency and Democrats seized sizable majorities in both chambers of Congress in January 2009, a second stimulus bill, the American Recovery and Reinvestment Act (ARRA), was swiftly enacted. Following the enactment of ARRA, the Obama administration and Congress proceeded to adopt policies impacting the taxation of offshore activities and the watershed health care legislation.

### Benefits for Indian Country

One provision of interest to the gaming industry contained ARRA was the creation of Tribal Economic Development (TED) Bonds. ARRA added a new provision to the Internal Revenue Code of 1986, as amended, allowing Indian tribal governments to issue bonds on a tax-exempt basis to finance any economic development project or other activities for which state or local governments may issue tax-exempt bonds under Code § 103. ARRA set a \$2 billion national volume cap for TED Bonds. The creation of TED Bonds has been significant for Indian country because it eliminates the “essential government” functions test in order for tribal governments to issue federally tax-exempt bonds. TED Bonds may not be used to finance facilities where Class II or III gaming is conducted. Furthermore, TED Bonds may only be issued during 2009 and 2010. Nevertheless, TED Bonds have allowed Indian tribes to access tax-exempt debt markets under substantially the same rules as are applicable to state and local governments.

### International Tax “Reform”

On May 4, 2009, President Obama and Treasury Secretary

Timothy Geithner introduced the administration’s international tax proposal. Obama’s 2009 proposal to change the U.S. system of international taxation was embodied by two general themes: First, eliminating certain benefits currently available under subpart F, which the administration perceived as avenues for gaming the tax system; second, eliminating the use of offshore “tax havens,” the popular nomenclature used to identify low-tax jurisdictions often used when structuring overseas activities of U.S. taxpayers. The administration’s 2009 proposal contained many provisions that have appropriately been viewed as strongly anti-business.

Congress began to target the subject of international tax with the enactment of the Foreign Account Tax Compliance Act (FATCA) as part of the HIRE Act. FATCA, in addition to other provisions, imposes tax withholding obligations on certain payments made to offshore accounts and non-U.S. entities and adopts robust disclosure obligations. The public policy driving FATCA lies with concerns over rampant abusive practices involving the use of offshore accounts and business activities intended to evade U.S. taxation. The notion of combating suspicious financial and money laundering activities is familiar within the gaming industry. Hence, the enactment of FACTA has significant importance to the gaming industry.

The Education Jobs and Medicaid Assistance (EJMA) Act, H.R. 1586, was signed into law on Aug. 10, 2010. The EJMA Act contains several provisions that are ostensibly intended to close perceived “loopholes” related to the use of the foreign tax credit (FTC). The EJMA Act was the subject of a November 2010 article in *Casino Enterprise Management*, “International Tax Reform: Loophole Closing or Anti-Business Measures?”

### Health Care Legislation

The rush by Democrats to enact the watershed health care legislation during a sputtering economy and increasing job losses likely contributed to dramatic demise of its majority in the U.S. House of Representatives and in many state legislative chambers. The health care legislation was enacted through a series of bills, which consisted of the Patient Protection and Affordable Care Act of 2010 and the Health Care Education Reconciliation Act of 2010 (collectively, the “Reconciliation Act”). In addition to mandating that most individuals obtain minimum health insurance coverage, the Reconciliation Act introduced several new tax rules.

## 2011: Remedies for the Future

With the historic gains by the Republican party across the United States in 2010, there will be a shift in the policy approaches with respect to several subjects of keen interest to the gaming industry at both the state and federal level. The following attempts to identify some of these key policy initiatives at the federal and state level.

### In Congress

The GOP has gained an astounding 63 seats in the House of Representatives, and the House of Representative is the chamber of Congress where all tax legislation constitutionally must originate. Therefore, the GOP will have a voice with tax policy beginning in 2011.

While specific legislative details have not emerged at the time this article was written, generally, the GOP is expected to

advance more taxpayer-friendly legislative policies, particularly for businesses. In addition, the GOP can be expected to increase congressional scrutiny of administrative agencies' implementation of the sweeping financial services regulation legislation and health care legislation. The general themes that can be expected to be embraced by the new GOP House majority include:

■ The benefits of participating in the GITCA Program is that a casino will be deemed to be in compliance with certain requirements of the federal tax law. ■

- Extending the lower tax rates Congress enacted in 2001 and 2003. In the lame duck session of the 111th Congress, Congressional Republicans have placed a priority on preventing an increase in tax rates as a result of the expiration of the 2001 and 2003 tax rate changes.

- Efforts to rollback some, if not all, of the massive new government programs and tax law changes arising from the passage of the Reconciliation Act.

- Curtailing the anti-business international tax measures advocated by the Obama administration.

- Enacting significant corporate tax law changes. Changes may include lowering corporate tax rates in order incentivize U.S. corporations to repatriate overseas earnings back to the U.S. The policy goal would be to encourage businesses to use overseas earnings for U.S. capital investments. A GOP House majority may also move to extend various business tax credits, such as the research and development credits.

A subject that has gained the attention of the international gaming community is i-gaming. During the 111th Congress, Congressman Barney Frank (D – Mass.) attempted to advance legislation that would establish a federal i-gaming licensing and regulatory system. Most Republican members of Congress have opposed these federal measures to authorize some form of i-gaming. Republicans are unlikely to move i-gaming legislation. Rather, congressional Republicans are expected to place a priority on legislation aimed to encourage job growth and ease regulatory burdens. With that said, in early December 2010, news broke that Senate Majority Leader Harry Reid (D – Nev.) is prepared to introduce legislation in the lame duck session that would authorize i-poker in the United States. A draft of Reid's legislation would allow casinos to operate i-poker sites and delegate regulatory oversight to state gaming regulators.

### In-State Legislative Houses

With Republicans picking up control of several state legislative chambers in the 2010 elections, gaming businesses will also need to closely monitor their legislative activity. Republicans

have historically taken a reserved approach to the expansion of gaming. Thus, conventional wisdom would dictate that there will not be widespread efforts to expand commercial gaming to new jurisdictions. With a GOP-controlled U.S. House, it is unlikely that the states, which still face significant budget shortfalls, will be able to rely on federal appropriations to close those shortfalls. As a result, the unique economic climate may spell opportunities to expand not only land-based commercial gaming, but also for states to authorize intrastate i-gaming as means for new revenue sources.

### Final Thoughts

The new GOP majorities in the U.S. House and several state legislatures will result in new remedies being offered to encourage economic growth. The GOP will likely focus on reducing the burden of tax incidence and easing government intervention in the markets. As new proposals are offered, there may be tax savings opportunities for gaming businesses, both in the form of lower taxes and in the form of fewer administrative burdens.

1 The IRS issued Notice 2009-51, which provided guidance with respect to TED Bonds. Notice 2009-51 provides a significant safe harbor for determining whether a structure will be treated as a separate building for purposes of the limitations prohibiting the financing of gaming-related facilities with TED Bonds. The safe harbor is extremely important because it opens the possibility for Indian tribes to finance ancillary structures, such as convention facilities or hotels, which may be connected to a gaming floor. The safe harbor provides that "a structure will be treated as a separate building if it has an independent foundation, independent outer walls and an independent roof." The notice specifies that connections, such as covered walkways or other enclosed common areas, may be disregarded if the connections do not affect the structural independence of either wall.

2 The health care-related tax rules created by the Reconciliation Act include:

- (1) A penalty tax for remaining uninsured after 2013— the penalty tax will be phased in beginning in 2014.
- (2) A tax credit for low-income individuals to participate in national health exchanges.
- (3) An excise tax on certain "Cadillac" health insurance plans.
- (4) Beginning in 2011, employers will be required to include the value of health insurance benefits on IRS Form W-2.
- (5) A 0.9 percent rate increase on the HI portion of FICA taxes for individuals earning more than \$200,000 and \$250,000 for married couples filing joint returns.
- (6) A 3.5 percent surtax on "net investment income" for taxpayers above certain threshold amounts.
- (7) Limiting health flexible spending account (FSA) contributions to \$2,500 and narrowing the scope of medical expenses that may be reimbursed through FSA and other similar tax preferred health accounts.

3 Republicans held majorities in both chambers of Congress when the Unlawful Internet Gambling Enforcement Act (UIGEA) was enacted in 2006. UIGEA ostensibly bans i-gaming.



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