

LEGISLATIVE COUNSEL BUREAU SUMMARY

of the

STUDY OF GENERAL FUND REVENUES

of the

STATE OF NEVADA

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**Legislative Commission
of the
Legislative Counsel Bureau
State of Nevada**

December 16, 1966

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PREFACE

At the 1966 special legislative session the legislative commission was directed by the legislature:

1. To conduct a thorough study of the principal sources of revenue for the general fund of the state;
2. To give priority in such study to additional gaming taxes and the economic positions of gaming;
3. To consider carefully the economic feasibility of any new or additional tax proposed;
4. To conduct such study under its existing statutory authority and within its existing appropriation; and
5. To report the results of such study to the 1967 session of the legislature.

In July 1966, the legislative commission engaged Lybrand, Ross Bros. & Montgomery to make the directed study. This firm ranks among the leading certified public accountant firms in the United States and provides, in addition to services conventionally associated with public accounting, actuarial services and management consulting services by a specialized staff of over 170 highly qualified consultants recruited from industry, from management consulting firms, university faculties, government agencies, and from the firm's other divisions. In August 1966, Lybrand, Ross Bros. & Montgomery was also directed by the legislative commission to examine the system of financial controls in force in a selected number of Nevada gaming establishments and to recommend measures for strengthening the control over accountability for taxes due to the State of Nevada.

Lybrand, Ross Bros. & Montgomery submitted its report to the legislative commission on November 22, 1966, and the report was accepted by the legislative commission on December 16, 1966. This pamphlet contains Part I of the report which is a digest or summary in nontechnical terms of the findings and conclusions emanating from the survey. For those persons interested in the underlying logic and substance, the detailed report should be carefully read. Copies of the detailed report may be purchased from the director of the

legislative counsel bureau, State Capitol, Carson City, Nevada,
at a price of \$1.50 per copy.

Upon acceptance of the report the legislative commission
raised three supplementary issues, dealing with the following ques-
tions:

1. What would be the effect on the profits of individual
businesses in the gaming industry if the percentage gaming
tax were increased at a variety of selected levels?
2. At what rates would games (cards, table games and slot
machines) have to be taxed to produce about \$5,000,000
annually in additional tax revenues as an alternative to
increasing the percentage tax?
3. If the percentage gaming tax were to be increased by 25
percent, would this have the effect of either or both of:
 - (a) Withdrawing from the industry funds now bor-
rowed from outside sources; or
 - (b) Materially reducing the availability of funds
to finance the future expansion of the industry?

The legislative commission has determined that meaningful
answers to these questions will be essential for the use of the 1967
legislature in its deliberations and actions and therefore has further
engaged Lybrand, Ross Bros. & Montgomery to provide the answers
during the forthcoming legislative session.

Legislative Commission
State of Nevada

Carson City, Nevada
December 16, 1966

STATE OF NEVADA
STUDY OF GENERAL FUND REVENUES

PART I

NEVADA'S FUTURE TAX PROBLEMS
AND THEIR IMPACT ON THE GAMING INDUSTRY

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NEVADA'S FUTURE TAX PROBLEMS
AND THEIR IMPACT ON THE GAMING INDUSTRY

The State of Nevada will shortly face the prospect of a deficit on its general fund. Several factors are forcing expenditures upwards at a faster rate than revenues. The population has risen sharply; the public is receiving additional services; inflation is moving salaries higher; and new federal programs are leading to heavier State outlays.

Nevada's fiscal record has been good. It has a balanced budget, no income taxes or death taxes, and a modest public debt. To maintain its enviable record, the State will probably have to increase taxes.

Public opinion has focused on gaming as a source of higher tax revenues. The gaming industry, on the other hand, contends that it is already highly taxed and an additional burden could cripple it. This might create a chain reaction and undermine the economy of Nevada, which is already heavily dependent on gaming - as an employer, a consumer, and a vital part of the tourist industry.

Is gaming's position valid? Or can it bear more taxes?

The study recently completed was made to examine this situation. Shorn of some of its more technical aspects, it was conducted to answer four fundamental questions:

1. What additional load has to be imposed on the taxpayers in the coming years?
2. What types and amounts of taxes are needed to prevent a deficit?
3. To what extent can the gaming industry bear higher taxes?
4. What is needed to improve administration of the gaming industry?

The report resulting from the study answers these and related questions. The study was extensive and penetrating. It involved many field interviews - with casino operators, with civic leaders, with financial institutions, with educators with government officials, and with others. It involved the gathering of volumes of confidential information from gaming licensees. Mathematical and statistical approaches were used, with the aid of an electronic computer. Information received was exhaustively questioned. Eventually, from the many sources of data gathered and processed, a picture emerged.

It is the purpose of this summary to describe that picture in non-technical terms. For those interested in the underlying logic and substance, the detailed report should be read.

Let us now address ourselves to the principal questions covered by the study.

1. WHAT ADDITIONAL LOAD HAS TO BE IMPOSED ON THE TAXPAYERS IN THE COMING YEARS?

Sights were set ten years ahead. Three specific years were studied:

- . the year ending June 30, 1968 - fiscal 1968
- . the year ending June 30, 1971 - fiscal 1971
- . the year ending June 30, 1976 - fiscal 1976.

Fiscal 1968 is of immediate interest to the Legislature, as a budget and fiscal plan have to be decided upon in 1967. Fiscal 1971 is of medium-term interest because of the time needed to plan for forthcoming changes and to make the necessary legislative arrangements. Fiscal 1976 - while far ahead - points to a landmark that shows the direction events should follow; it is important for longer-range planning.

In forecasting the deficit for future years, we relied substantially on estimates made by authorities in the State government. These estimates were prepared according to specified guidelines; they were questioned; and where appropriate, they were adjusted by mutual agreement.

If no changes are made in the present taxes or tax rates, the State may expect to experience the following results on its general fund account:

<u>Fiscal year</u>	<u>In millions of dollars</u>		
	<u>Outlays</u>	<u>Revenues</u>	<u>Gaps</u>
1968	74	65	9
1971	104	84	20
1976	175	130	45

Many conditions, now unpredicted, can occur to change the expected picture. And the farther one projects into the future, the more uncertainties exist. The future becomes clearer as each year passes by.

With circumstances and trends as they can best be judged today, the State faces a deficit of \$9 millions in fiscal 1968, mounting to \$45 millions in fiscal 1976.

There are, of course, two sides of the coin. A deficit can also be avoided, or at least minimized, by reducing outlays. This possibility, we are sure, is under constant watch. Nevertheless, we have assumed that the expected outlays taken into account are realistic, and our study was not intended to explore ways of reducing costs.

In any event, the burden on the taxpayer will be high.

2. WHAT TYPES AND AMOUNTS OF TAXES ARE NEEDED TO PREVENT A DEFICIT?

In viewing the avenues open to the State, we compared and contrasted the tax structure of Nevada with those of other states. We disregarded such factors as the political unpopularity of certain types of taxes and present obstacles imposed by the State Constitution.

Bold action may be needed to avoid future deficits. Some taxes that are now politically unpopular may be essential reservoirs of future State revenues in face of the needs as they are now projected.

Despite current political thinking and present constitutional bars one cannot escape the conclusions that:

- . New taxes have to be levied, and
- . Rates of present taxes have to be increased.

Each of these issues is now considered.

(1) New taxes have to be levied

The State will be well advised to introduce three new forms of taxation: death taxes, individual income taxes, and corporate income taxes.

The levy of death taxes would require a constitutional amendment. It is proposed that the State use the same plan as that adopted by Alabama, Arkansas, Florida, Georgia and Mississippi. In these states a portion of the death duties which would have otherwise gone to the federal government goes to the states. There is no cost to the estate of the deceased.

Other states commonly use individual and corporate income taxes, but this source is not tapped in Nevada. These taxes are invariably unpopular, but a sound fiscal policy rarely wins a popularity contest. Nevadans paying federal income taxes would, at any rate, gain some measure of relief if their State income taxes are deducted for federal tax purposes.

Our report offers suggestions for income tax administration that would keep the cost of collection at a minimum and would save Nevadans the chore of filling in elaborate income tax returns

(2) Present tax rates have to be increased

Many opportunities exist for increasing present taxes. In some cases, where the tax payments qualify as deductions for federal income tax purposes, Nevadans would be relieved of the full cost of the higher tax rates..

The sales and use tax and gaming taxes are Nevada's most prolific revenue-producers. They are obvious candidates for increases because the cost of collection would not rise and the amounts collected could be large. However, increases would have to be kept within reasonable bounds to avoid overburdening the classes of taxpayers concerned. (An increase to a rate as high as 4 percent in the sales and use tax is not considered feasible unless food purchased for home use is exempted from sales tax.)

Liquor taxes and licenses, as well as cigarette taxes and licenses, are useful vehicles for raising additional tax revenues. On the other hand, their capacity to add materially to State revenues is limited.

Another, and less often considered, source of revenue is an increase in the host of fees, licenses, service charges and similar levies collected by the State. The rates are, in many cases, inadequate to reimburse the State for the services it performs; and an increase should create little hardship.

Based on these considerations, we present four alternative tax programs to bridge the expected revenue gap in each of the fiscal years 1968, 1971 and 1976. The first three programs are illustrative and, taken by themselves, have shortcomings. The fourth program merits consideration because it spreads the additional tax burden over a broader cross-section of taxpayers. It may therefore be recommended.

First alternative program - consumer impact

The first program is based on heavier taxation of the consumer. Its structure and effects are as follows:

	Expected additional amounts in millions of dollars		
	<u>Fiscal 1968</u>	<u>Fiscal 1971</u>	<u>Fiscal 1976</u>
Fees, licenses, fines and charges*			
Increase present rates by 100 percent	2.6	3.2	4.3
Death tax			
As discussed above	-	0.9	1.2
Liquor tax and licenses			
Increase present rates by 50 percent	1.8	2.3	3.1
Cigarette tax and licenses			
Increase tax by 2¢ a pack and licenses proportionately	0.5	0.6	0.8
Sales and use tax			
Increase rate to 3 percent, starting February 1, 1968	4.7	14.5	23.8
Corporate income tax			
Levy tax equivalent to 16 percent of present federal rates	<u>-</u>	<u>-</u>	<u>12.3</u>
Totals from the foregoing	9.6	21.5	45.5
Estimated revenue gaps	<u>9.0</u>	<u>20.0</u>	<u>45.0</u>
Estimated surpluses	<u>0.6</u>	<u>1.5</u>	<u>0.5</u>

* This item, and all future references to it, excludes licenses for gaming, liquor and cigarettes, as these latter are considered separately.

Second alternative program - gaming impact

The second program is directed predominantly toward heavier taxation of the gaming industry as follows:

	Expected additional amounts in millions of dollars		
	<u>Fiscal 1968</u>	<u>Fiscal 1971</u>	<u>Fiscal 1976</u>
Fees, licenses, fines and charges			
Increase present rates by			
100 percent	2.6	3.2	4.3
Death tax			
As discussed above	-	0.9	1.2
Gaming tax			
Increase percentage tax*			
overall by:			
35 percent	6.6		
70 percent		16.8	
100 percent			34.9
Corporate income tax			
Levy tax equivalent to 6			
percent of present federal			
rates	-	-	4.6
Totals from the foregoing	9.2	20.9	45.0
Estimated revenue gaps	<u>9.0</u>	<u>20.0</u>	<u>45.0</u>
Estimated surpluses	<u>0.2</u>	<u>0.9</u>	<u>none</u>

* It is assumed here, and throughout the report, that the gaming tax increase will be made by way of a surcharge, that the percentage tax will be calculated in the customary manner and that a surcharge, at the rates here indicated, will be added. The actual process may prove to be different, but this approach is the simplest, both for understanding and for calculation.

Third alternative program - income impact

In the third program, which follows, the major emphasis is on income taxes, both individual and corporate.

	Expected additional amounts in millions of dollars		
	<u>Fiscal 1968</u>	<u>Fiscal 1971</u>	<u>Fiscal 1976</u>
Fees, licenses, fines and charges			
Increase present rates by			
100 percent	2.6	3.2	4.3
Death tax			
As discussed above	-	0.9	1.2
Corporate income tax			
Levy tax equivalent to the			
following percentages of			
present federal rates:			
6	2.8		
12		6.9	
20			15.4
Individual income tax			
Levy tax equivalent to the			
following percentages of			
present federal rates:			
2	3.6		
4		9.1	
8	—	—	24.1
Totals from the foregoing	9.0	20.1	45.0
Estimated revenue gaps	<u>9.0</u>	<u>20.0</u>	<u>45.0</u>
Estimated surpluses	<u>none</u>	<u>0.1</u>	<u>none</u>

Fourth alternative program - balanced impact

None of the three programs presented thus far would be acceptable. The first would draw revenue predominantly from the consumer, the second from the gaming industry, and the third from the income-earner in Nevada. A sound tax program spreads the burden more equitably across all taxpaying segments.

The fourth program, presented on the next page, is an approach to a balanced tax structure.

	Expected additional amounts in millions of dollars		
	<u>Fiscal 1968</u>	<u>Fiscal 1971</u>	<u>Fiscal 1976</u>
Fees, licenses, fines and charges			
Increase present rates by			
100 percent	2.6	3.2	4.3
Death tax			
As discussed above	-	0.9	1.2
Liquor tax and licenses			
Increase present rates by			
50 percent	1.8	2.3	3.1
Cigarette tax and licenses			
Increase tax by 2¢ a pack and			
licenses proportionately	0.5	0.6	0.8
Gaming tax			
Increase percentage tax			
overall by:			
25 percent	4.7		
35 percent		8.4	
50 percent			17.4
Corporate income tax			
Levy tax equivalent to the			
following percentages of			
present federal rates:			
5	-	2.9	
12 1/2			9.6
Individual income tax			
Levy tax equivalent to the			
following percentages of present			
federal rates:			
1 1/4	-	2.8	
3			<u>9.1</u>
Totals from the foregoing	9.6	21.1	45.5
Estimated revenue gaps	<u>9.0</u>	<u>20.0</u>	<u>45.0</u>
Estimated surpluses	<u>0.6</u>	<u>1.1</u>	<u>0.5</u>

It is of interest to assess the impact of this program. After deducting those portions of the estimated gaps in revenue met through miscellaneous fees, etc. and death taxes, the suggested additional taxes would be borne as follows:

SPREAD OF ADDITIONAL TAXES AMONG MAJOR TAXPAYING GROUPS

	<u>In millions of dollars</u>			<u>In percentages</u>		
	<u>Fiscal 1968</u>	<u>Fiscal 1971</u>	<u>Fiscal 1976</u>	<u>Fiscal 1968</u>	<u>Fiscal 1971</u>	<u>Fiscal 1976</u>
Consumer taxes						
Liquor and cigarette	2.3	2.9	3.9	33	17	10
Gaming tax	4.7	8.4	17.4	67	49	43
Income taxes						
Corporate and individual	<u>-</u>	<u>5.7</u>	<u>18.7</u>	<u>-</u>	<u>34</u>	<u>47</u>
Totals	<u>7.0</u>	<u>17.0</u>	<u>40.0</u>	<u>100</u>	<u>100</u>	<u>100</u>

Taxes levied directly on the consumer decrease steadily in significance after fiscal 1968. The gaming tax, at an increase of 25 percent, bears a relatively high proportion of the increased taxation in fiscal 1968, but its relative contribution declines after then, despite rate increases. Income taxes are scheduled to increase in stages, both in amount and in proportion. (On the other hand, an alternative increase in the sales tax would reduce the need for reliance on income taxes.)

3. TO WHAT EXTENT CAN THE GAMING INDUSTRY BEAR HIGHER TAXES?

Perhaps the most intricate and exacting part of the study was to evaluate the gaming industry's ability to pay higher gaming taxes.

To do this, we studied the industry's figures in detail; we gathered data from licensees by questionnaires, and our representatives followed up, in many cases, with field interviews. Deficiencies and inconsistencies in the data compelled adjustment to put them into a form suitable for analysis. After rejecting unsuitable returns, we covered a sample representing 75 percent of the business done by the industry in Nevada.

It was found possible to make a satisfactory projection of gaming revenues over the years ahead. This was done through statistical analysis, involving the calculation of equations through an electronic computer.

On the other hand, the many unknown factors affecting future operations made it difficult to project the industry's expenses. Two of the most difficult and controversial issues to be solved were these:

- . How much will costs rise, and how effective will management be in controlling them? (We assumed three different trends - one a return to the satisfactory experience of a year or two ago, a second reflecting a holding of expenses at current proportionate levels, and a third assuming a continuously increasing proportion of expenses.)
- . To what extent will the industry be able to pass on any increase in gaming taxes by reducing odds to customers or by increasing charges for hotel, restaurant, bar or other services? (We assumed four alternatives, ranging from no recapture to full recapture.)

The conclusions drawn from the analysis were these:

- (1) An increase of 200 percent of the present rates would make serious inroads into gaming profits

If gaming tax rates were increased by 200 percent - the approximate effect of the initiative petition receiving attention during our study - gaming profits would probably be reduced to less than 5 percent on owners' capital, before deducting any tax increases (other than on gaming) in Nevada. The less efficient licensees would undoubtedly be put out of business, and even the more efficient ones might find it difficult to attract the necessary capital because of the low return. The investor would find it more profitable to put his money into blue chip stocks or bonds, and would, by so doing, assume a lower risk.

The consequences of such a tax increase might conceivably be a decline of such magnitude that the economy of Nevada could be seriously affected. Moreover, revenues from gaming taxes might increase by a lower rate than the size of the tax increase would indicate.

(2) The industry can bear some increase in gaming tax rates

Our projections indicate that an increase in the rate of gaming taxes of 25 percent would permit the industry to earn about 12 percent a year on capital, subject to other increases in taxes in Nevada. A 50 percent increase would produce a return of about 11 percent, and a 75 percent increase would produce a return of about 10 percent.

These returns might not be very attractive to the investor of risk capital. Against this, however, it must be recognized that:

- . Percentage returns represent industry averages. The better managed concerns earn higher profits.
- . These projections make no allowance for recoupment of any part of the tax increase. The industry argues that it would be hard to pass on any of the tax burden to the customer. We cannot help but conclude, nonetheless, that circumstances would lead at least to its partial recapture.
- . The impact of higher taxation would undoubtedly lead to tighter control over expenses. We gained the impression that some of the industry's expenses can be reduced in relation to the volume of business.

Even moderate increases in the tax rate would bring about some business failures. But the industry is typified by a high rate of turnover in ownership; some licensees are going out of business even though others earn satisfactory profits.

(3) An abrupt increase in the gaming tax could harm the industry

Some time will inevitably be needed by the gaming industry to gear itself to the impact of a substantial increase in gaming taxes. It would have to take such countermeasures as reducing its other expenses or services, and increasing charges to customers, whether by raising hotel, restaurant, bar or other charges or by reducing odds. Licensees should be able to take these actions successfully, but probably not rapidly. A program of year-by-year increases of relatively small amounts, rather than a sharp one-time increase in tax, should allow the industry to adjust in a more orderly manner.

It was not the purpose of our study to pass judgment on the merits of the important role of gaming in the economy of Nevada. We have accepted the fact that it is, indeed, significant. Any marked decline in the fortunes of the industry would, in turn, react adversely both on the State's economy and on its budgetary position.

4. WHAT IS NEEDED TO IMPROVE ADMINISTRATION OF THE GAMING INDUSTRY?

The public of Nevada is well aware of recent allegations that gaming licensees have indulged in "skimming" - concealing part of their winnings and thus evading taxes.

We did not attempt to determine whether these allegations had substance. On the other hand, we examined the practices and procedures of some of the larger licensees - selected because of their reputedly good

management - and of the regulatory agencies. Our examinations of these licensees revealed no evidence of skimming, but this of itself should not be accepted as a statement that it does not occur. Opportunities do exist for improvement - both to minimize the chance of skimming and to provide for better management of the affairs of the industry.

A program to achieve these improvements calls for the following action:

- (1) Establish and enforce standards for better controls within the licensee organizations, particularly those controls which affect the handling of money and its equivalent.
- (2) Require licensees to adopt uniform methods of reporting their financial results. This is common in most other regulated industries.
- (3) Set up a central body to conduct economic research concerning the gaming industry.
- (4) Broaden the scope of independent audits of licensees.
- (5) Strengthen and modernize the State's auditing of licensees' operations.

If this program is adopted and put into effect, it should reduce present opportunities for tax evasion; it should give owners better protection against loss caused by their employees; it should demonstrate the State's determination to accept its responsibilities for regulating the industry; and it should help build a better reputation for the industry itself by reason of its using more businesslike practices.

* * *

The reader is asked to recognize that projections of future revenues and outlays, of additional income from taxation, and of future earnings of the gaming industry are, in fact, projections. They are not predictions.

Projections are based on the use of assumptions that judgment and experience dictate to be valid. If any of these assumptions proves to be materially wrong - for example, if there were an outbreak of a major war, or if a serious depression occurred - the projections based on these assumptions would prove wrong, as also might the conclusions. In the light of current conditions, however, the projections have been based on the best available facts and judgments.