Impact on the State of Proposed Increase in the Wagering Tax to 36%

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The purpose of the proposed wagering tax increase is to raise $195 million in new tax receipts to offset a reduction in the top marginal brackets of Iowa's corporate income tax. Those who proposed this tax increase apparently assumed that the proposal would not have an impact on casino operations in terms of employment, purchases, customers and mix of gaming activities. They must have assumed that tracks and casinos 1) would have the resources to pay the higher tax rate and 2) would not be forced to adopt severe changes. Both assumptions were wrong.

On the day Governor Branstad announced this tax plan, the Iowa Gaming Association commissioned Strategic Economics Group (SEG) to analyze the facts, determine how the gaming industry would most likely respond to this threat and determine the likely impact on the state and on the communities where tracks and casinos are located.

In order to anticipate the survival strategy of Iowa's casino managers, SEG analyzed eight years of audited financial statements for each of Iowa's gaming facilities, examined whitepapers and survey responses provided by their managers and interviewed a substantial number of them.

We examined the current financial status of the Iowa gaming industry following two years of recession. Notwithstanding the widely-held perception that the industry is awash in cash, we found that four facilities currently show negative corporate equity. Another five had income[2] on their books of less than $10 million – much of which may already be obligated in support of loans.

Our interviews with facility managers indicated that if confronted with the proposed tax increase, their strategy would be to first reduce payrolls, amenities, purchases and advertising - in other words, downscaling. Next they would draw from that portion of net income that was not otherwise committed as collateral to cover any remaining tax obligation. If those two sources were not sufficient, the managers would dip into the fund that covers capital reinvestment – for those who had such funds available. Any additional unpaid tax balance would mean that the facility would lose its license and would be forced to close.

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[1] Strategic Economics Group is headed by Harvey Siegelman. Mr. Siegelman served 16 of his 20 years as State Economist under Governor Branstad.

[2] Income includes earnings before interest, taxes, depreciation and amortization (EBITDA). It is the measure used by lenders to determine creditworthiness.

We presented our analysis to a meeting of the track and casino general managers for a reality check and they generally agreed with the conclusions. However, several managers felt that the research would benefit by a micro-level analysis of the strategy differences among the various facilities. Over the following week we surveyed each individual manager regarding how they would change each income and expense category in response to the tax increase. Their collective average behavior was remarkably similar to the industry norms which we used in our first analysis.

With this framework, using the most recent financial statements and validating the contingency scenario of each facility manager, here is what we believe will be the consequence of increasing the wagering tax to 36%:

1. Four of the 17 facilities will most likely close; two more will be in financial difficulties and may also need to close or restructure, two more will not have sufficient resources to pay all of their tax liability.

2. The downsizing will reduce costs but will also lead to a decline in revenues as the facilities will lose some of their market. As a result Adjusted Gross Receipts (AGR) will decline from $1.37 billion in 2010 to $712 million because of the downsizing and closings. Consequently, the proposed wagering tax collection will only increase $83 million toward the $195 million goal. If six facilities are forced to close their doors, the $83 million gain becomes a $42 million loss.

3. The downsizing will cause the layoff of 2,600 workers, assuming none of the facilities are forced to close. Forced closures would cause the total number of jobless to exceed 4,500 and payrolls to fall by more than $150 million per year.

4. The jobless benefits that will be necessary to cover those displaced workers will cost about $37 million. And the state will lose about $3.3 million in the income tax which those displaced workers previously paid.

5. The facilities that will close will no longer pay their local communities the $8.5 million in annual property taxes, nor will the community and the state receive the $1.5 million in hotel/motel tax from the downsized facilities.

6. State sales tax collections will decline by $1.7 million as a result of downsizing and by another $1.2 million because of closures.

7. Local communities will also lose about $5 million from their share of the wagering tax and they will see a $17 million cutback in civic and charitable contributions because of the closures. But, more importantly, for many of those communities they will lose a major tourism attraction and a partner in their economic development effort.

8. The thousands of Iowa vendors of food, supplies and services will lose as much as $265 million in yearly sales to the casinos and tracks that have been forced to downsize or close. The list of vendors covers the entire state; located in every legislative district.

9. The impact of the proposed tax increase is not limited to casinos, their employees, vendors and communities. It will also affect all Iowans through the reduced paychecks, and the lower level of goods and services purchased. Plugging the above numbers into the Iowa IMPLAN[3] model indicated that up to 6,800 employees in the state will have their jobs jeopardized, about $940 million in consumer spending in Iowa will be lost and the total personal income of Iowans will be diminished by $190 million as a result of this proposal.

10. In 2010, Iowa's casinos and tracks paid to the State a total of more than $335 million, including wagering taxes, license fees, sales tax and corporate income tax. The earnings left over for their owners, after deducting those taxes, other business expenses and an allowance for capital reinvestment, was $245 million. On that basis, the State is currently getting a greater return from the casinos and tracks of Iowa than even their corporate shareholders.

[3] Strategic Economics Group applied the IMPLAN statewide regional economic input-output model to determine the magnitude of secondary economic impacts. MIG, Inc. is the corporation that is responsible for the production of IMPLAN (IMpact analysis for PLANning) data and software.