

### **Is Internet Gaming a Good Bet for Pennsylvania?**

Pennsylvania's budget for fiscal 2015-2016 is now more than four months overdue. The stalemate is focused on the Governor's desire to raise taxes on income, and Marcellus Shale drillers to generate revenue to pay for a huge boost in spending while the Legislature desires to avoid some, if not all, of the proposed tax hikes. However, one possible new revenue source that has received considerable attention from both sides is to tax internet gaming, which, of course has yet to be enacted. Both sides in the budget clash seem to agree it might be a possible answer. But would it offer substantial help for the Commonwealth's fiscal problems?

The short answer is no. An internet gaming tax is unlikely to generate enough money to make a meaningful contribution to state government revenue.

Internet gaming is legal in only three states: Delaware, Nevada, and New Jersey. To gauge the impact of internet gaming in Pennsylvania, we will look at the experience in New Jersey as a likely indicator of what the revenue potential might be in the Commonwealth.

By way of background, New Jersey legalized internet gaming early in 2013 and by November of that year, casinos were taking their first online wagers. According to the New Jersey Casino Control Act, "a casino's primary Internet gaming operation, including facilities, equipment and personnel who are directly engaged in the conduct of Internet gaming activity, shall be located within the territorial limits of Atlantic City, New Jersey."<sup>1</sup> All internet gaming takes place on servers and computer equipment (hardware, software, and equipment) physically located within Atlantic City's casinos. All gaming activity takes place on the servers at the facility and the information is transmitted to players along common carriage lines outside of the casino premises. Thus, technically, all games and wagering are taking place inside the casino. In 2013, there were twelve casinos operating in Atlantic City, six of which were involved in internet gaming with a combined 13 gaming websites—Caesars Casino had the most websites with four. By 2015 the number of casinos involved in internet gaming fell to five and the number of websites increased to 14—Borgata joining Caesars with four.

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<sup>1</sup> New Jersey Casino Control Act of 1977 (amended), Article 6C Internet Gaming.

Only New Jersey residents, physically located within the state at the time of wagering, are allowed to play. Their presence is to be verified through an IP address, local wireless connections mapping, and cellular data. The player must set up an account using a legal name, valid address, phone, and e-mail, a date of birth, and proof of identity. Once the account has been created, the player deposits funds into the account from which wagers are placed.

New Jersey imposes a tax on internet gross revenues, the amount wagered on games through an approved website less the payout of winnings, at rate of 15 percent. In 2014, the first full year of internet gaming, the state collected roughly \$18.5 million in tax revenue—implying \$123.1 million in gross revenues. Through three quarters of 2015, New Jersey was on annualized pace to collect \$21.8 million in taxes on \$145.1 million in gross revenues. Given New Jersey's 2014 total gross revenue figure of \$123.1 million and population of 8.9 million people, estimated per capita gross revenue is placed at \$13.80. For 2015's estimated gross revenue of \$145.1 million, the amount per capita has increased to \$16.24.

Using New Jersey's revenue performance as a template, and taking Pennsylvania's population of 12.8 million and assuming \$14-\$16 per capita in internet gross revenue, the casinos in the state should expect total gross revenue of anywhere from \$179 million to \$205 million. Of course, how the number of internet sites in Pennsylvania and other legally determined restrictions compared to New Jersey could make a difference, up or down. One gaming expert predicts Pennsylvania could top \$300 million in online gaming revenues in the first year, but as we have seen with gaming predictions in the past, they are often grossly overstated (see *Policy Brief Volume 10, Number 43*).

The amount of revenue generated for the state will of course depend upon the tax rate chosen. Using 15 percent as a starter, the tax would provide anywhere from \$27 million to \$31 million in annual revenue based on the gross revenues estimated above. Using the current slot machine rate of 34 percent (also the rate on fully automated table games) would place that range at \$61 million to \$70 million.

The license fees would provide a separate and upfront revenue payment to the Commonwealth. News reports are suggesting the upfront fee would be \$5 million. Assuming all twelve casinos jump on the online bandwagon, that gives the state another \$60 million. But this would be a one-time payment. New Jersey collected an issuance fee, which, according to their Gaming Act, is to be no less than \$400,000. Thereafter they collect an annual renewal fee which shall not be less than \$250,000. These amounts go to the state coffers, but they also add \$250,000 for compulsive gaming treatment fee to each license and renewal. With a \$400,000 first time initial fee, not counting the \$250,000 dedicated for gaming treatment programs, New Jersey collected \$2.4 million in 2013. They have collected another \$1.5 million in annual renewal fees each year since. As long as the number of casinos offering internet gaming remains constant, they will continue to do so.

Thus Pennsylvania's choice of fees will determine how much is collected. Bear in mind that the state will incur management and administration costs in levying and collecting the new tax along with substantial expenses in setting up the systems and regulatory mechanisms. These costs will presumably come out of license fees and annual tax collections.

Keep in mind that internet gaming complied with Federal and state laws in New Jersey because it only applies to *intrastate* gaming, not *interstate* gaming—that is, only New Jersey residents are allowed to play and only when they are physically located within that State's borders. Similar constraints would apply to Pennsylvania—only Pennsylvania residents would be allowed to play. Thus in order for the casinos to see \$200 million per year in online gaming play, to give the State coffers tax money of up to \$70 million, Pennsylvania residents have to *lose* \$200 million annually. Unlike the casinos where residents from other states can play (and lose), thereby filling gaming tax coffers, this tax would fall solely on residents of the Keystone State.

Big question: How will internet gaming affect visits by locals to the casino and resident play at casinos? That might be a much more important question in Pennsylvania than it is in New Jersey because internet gaming is set up in Atlantic City where a high percentage of the business is non-residents. Then too, is the profitability of internet gaming sufficient for an operation to be sustainable if the tax rate is above 15 percent?

Some thought should be given to these questions before the Commonwealth ventures too far down this road.

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