Nancy Todd Tyner

Casino Journal

August, 2002

Sitting Ducks

Will the Illinois cash grab set the pace for other riverboat states?

What's the heaviest tax burden a riverboat can bear? We may soon find out.

On Sunday, June 2, the Illinois General Assembly delivered a budget package to Governor George Ryan that would hike taxes on the state's top performing riverboat casinos from 35 percent to 50 percent and increase admission taxes from $2 to $3 per person.

Before the hike, Illinois' graduated tax structure already soaked its most successful casinos at a higher rate than any other state. With the increase in effect July 1, casinos with gaming revenue of $25 to $150 million face a 2.5 percent rise, those that earn $150 to $200 million pay an additional 10 percent, and those with over $200 million in revenue fork over half of that money to the state.

The revenue and admissions increases are projected to fill $130 million in budget spending.

It's not the first time Illinois riverboats have been in the crosshairs of desperate lawmakers -- just last year the House considered a boggling 80 percent tax on casino profits to cover a $400 million budget gap. While that proposal was a little too greedy to pass Go, this one apparently seemed plausible enough to pass.

However rational a 50 percent tax rate may have been to lawmakers at the end of an arduous budget process, investors took a different view.

The Monday after the news was announced, a Standard & Poor's index of gaming stocks sank nearly six percent, the deepest one-day loss since its 15.6 percent dive on Sept. 17, when U.S. markets re-opened in the wake of the terrorist attacks.

Hardest hit were the companies that operate in Illinois. Shares of Argosy, Hollywood, Boyd, Harrah's, Aztar and Mandalay Bay fell between 7.7 percent and 20 percent on the New York Stock Exchange.

The slide continued through the month of June, as Illinois Governor George Ryan gave an implicit nod to the tax hike and lawmakers in neighboring Indiana started finalizing a budget that would also include new riverboat taxes. (At the time of this writing, Indiana's tax increases were still pending.) By mid-June, Argosy shares had fallen 26 percent and Hollywood was down a depressing 40 percent.

As their stocks slumped, Illinois operators started projecting the direct costs of the tax. Mandalay said it will cost about $40 million in annual operating income, and Argosy said it expects to pay an additional $24 million in taxes in the coming fiscal year. Hollywood said the new tax essentially would negate all expected returns from the newly finished $78 million renovation and expansion of its Aurora casino.

In a Reuters report, Hollywood's CEO said that while the company was "thrilled to be providing our customers with a superior gaming and entertainment product, our enthusiasm is tempered ... by the dramatic increase in gaming taxes recently passed by the Illinois legislature."

A spokesman for Harrah's, which owns two casinos in the state, offered a more ominous response to another news agency. "No business can sustain that tax rate," he said.

MGM Mirage, meanwhile, was in a rare position to take immediate action after the tax hike was announced. On June 4, the company backed out of its $615 million offer to buy the stalled Emerald Casino planned for the town or Rosemont, explaining that lawmakers had created a hostile environment for riverboat gambling in Illinois.

"The philosophy of the legislature apparently is when it gets into a situation of needing more money, it just raises taxes of the gaming industry alone," an MGM Mirage spokesperson was quoted in the Chicago Tribune. "If that's the attitude, maybe there are other places our money is invested more responsibly."

(With or without MGM, the fate of the Emerald license is uncertain as its owners fight allegations of wrongdoing by the Illinois Gaming Board and attempts by the town of Rosemont and several creditors to force the project into bankruptcy. Although it's likely that another operator will be found, MGM's withdrawal may mean a lower purchase price and a longer wait.)

It's not often that a casino company can send such an emphatic message to state lawmakers. "Elsewhere" is generally not an option when a license has been purchased in a particular state and a casino is already running. With so few markets open to private casino gambling and so few licenses available, gambling companies rarely can play hardball with greedy state lawmakers; they simply have no bargaining power.

It's also meaningful that investors reacted so immediately and dramatically to the news of the tax increase, signaling concerns that the legislature crossed the line -- and that other Midwestern states might follow suit.

But neither of these warning signs was clear enough to persuade lawmakers or the governor to reconsider the riverboat tax plan. The week after he'd received the Assembly's budget, Governor Ryan forced lawmakers to reconvene in a special session to deal with half a billion dollars in vetoed spending -- including $176 million cut from state funds for education -- but he didn't lay a finger on the casino tax plans.

(Increased funds from federal and local sources are expected to mitigate most of those education cuts, but it's still rankling that reductions in school funding would accompany such huge increases in riverboat taxes.)

When the initial repercussions have passed, the deeper effects of Illinois' aggressive tax structure will be less dramatic but probably more destructive. It could take years of shrinking revenue and hostile relations between casino operators and regulators before lawmakers realize that they've simply squeezed too hard on an increasingly critical revenue stream.

Even worse, Illinois' cash grab sets the pace for other riverboat gaming states. The latest budget package in Indiana would raise admission fees from $3 to $4 per person while refusing to loosen boarding restrictions and expand slot machine licenses. Iowa's governor meanwhile, wants to boost riverboat taxes from 20 percent to 32 percent in the wake of a state Supreme Court decision that the state can't tax racetrack and riverboat casinos at different rates. Missouri had considered moving from a flat 20 percent tax to a graduated system with a ceiling of 30 percent earlier this year. With a 50 percent levy in Illinois, surrounding states are bound to ratchet up their rates.

Those states should watch Illinois for three to five years. It may turn out that a thriving riverboat industry can withstand higher taxes, (albeit an unfair increase) than casino companies and investors believe; apparently Illinois lawmakers are bent on testing that threshold. If they're wrong, that fallout of that miscalculation should be limited to one market, not spread over an entire industry. Unfortunately, patience is not a common virtue among lawmakers facing billion-dollar budget gaps.

Of course, the ideal scenario for the casino companies would be widespread legalization that would offer the freedom of mobility and leverage against unreasonable tax policies that other industries enjoy. But let's not get carried away -- surviving hunting season is the first order or business for the heartland's riverboats.

Nancy Todd Tyner is an international political consultant specializing in the gaming industry. Her firm, Nancy Todd, Inc., is located in Las Vegas, Nevada. She can be reached at 702-845-1265 or at www.NancyTodd.com.