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BILL ANALYSIS



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House Bill 4311 (Substitute S-1 as reported)
House Bill 4312 (Substitute S-1 as reported)
House Bill 4323 (Substitute S-1 as reported)
Sponsor: Representative Brandt Iden (H.B. 4311)
Representative Wendell Byrd (H.B. 4312)
Representative LaTanya Garrett (H.B. 4323)
House Committee: Regulatory Reform
Ways and Means
Senate Committee: Regulatory Reform

CONTENT

House Bill 4311 (S-1) would create the "Lawful Internet Gaming Act" to do the following:

- Allow internet gaming to the extent that it was carried out in accordance with the proposed Act.
- Prescribe the responsibilities of the Michigan Gaming Control Board (MGCB) regarding effectuating and enforcing the proposed Act.
- Allow the MGCB to issue applicants an internet gaming operator license if they met certain criteria.
- Prescribe a \$50,000 application fee, a \$100,000 initial license fee, and a \$50,000 annual fee for an internet gaming license.
- Allow an internet gaming license to be issued only to a casino licensee or, under certain conditions, to a Michigan Indian tribe that operates a casino in the State.
- Allow the MGCB to license internet gaming suppliers to provide goods, software, or services to internet gaming operators.
- Prescribe a maximum \$5,000 application fee, a \$5,000 initial license fee, and a \$2,500 annual fee for an internet gaming supplier.
- Provide that a license would be valid for five years and could be renewed for additional five-year periods.
- Impose a graduated tax on the adjusted gross receipts received by an internet gaming operator from internet gaming, and list how the collected taxes would have to be distributed.
- Require an internet gaming operator to provide, or to require the internet gaming supplier providing its internet gaming platform to provide, adequate gaming participant verification measures, including mechanisms to detect and prevent the unauthorized use of internet wagering accounts and to detect and prevent fraud, money laundering, and collusion.
- Allow the MGCB to develop responsible gaming measures, including a statewide responsible gaming database identifying individuals who were prohibited from establishing an internet wagering account or participating in internet gaming offered by an internet gaming operator.
- Create the "Internet Gaming Fund" and require fees and taxes to be deposited into the Fund.
- Require the MGCB to spend money from the Fund for the Compulsive Gaming Prevention Fund, the First Responder Presumed Coverage Fund, the Board's costs of regulating and enforcing internet gaming, and the School Aid Fund.

- Prescribe a felony penalty of imprisonment for up to 10 years and/or a maximum fine of \$100,000 for a person who was not an internet gaming operator and offered internet gaming for play in the State.
- Prescribe a misdemeanor penalty of imprisonment for up to one year or a maximum fine of \$10,000 for specified actions taken by an individual.
- Specify that, if required by law, the Board would have to require a person to submit his or her fingerprints for review by the Department of State Police and the Federal Bureau of Investigation for the criminal history record check, and list further related responsibilities for the Department.
- Require a person who held a casino license under the Michigan Gaming Control and Revenue Act to provide to the Board a monthly report regarding certain gaming operations.

House Bill 4312 (S-1) would amend the Code of Criminal Procedure to create in the sentencing guidelines a Class D felony against public order for internet gaming offenses, and a Class G felony against public trust for bingo - false statements.

House Bill 4323 (S-1) would amend Chapter 44 (Gambling) of the Michigan Penal Code to exclude gaming conducted under the proposed Lawful Internet Gaming Act from the chapter of the Code, which prescribes penalties for illegal gambling activities.

MCL 777.14d (H.B. 4312)
Proposed MCL 750.310d (H.B. 4323)

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

House Bill 4311 (S-1) would have an indeterminate fiscal impact on a variety of State funds and local units, including:

- The School Aid Fund (SAF).
- The City of Detroit.
- The Michigan Agriculture Equine Industry Development Fund (AEIDF).
- The Michigan Strategic Fund and Michigan Economic Development Corporation (MSF/MEDC).
- Local units that receive Tribal gaming revenue sharing payments.
- The Compulsive Gaming Prevention Fund.
- The Michigan Gaming Control Board.
- The First Responder Presumed Coverage Fund.

Estimating the fiscal impact is difficult because of the current number of gaming activity options in the State. Michigan provides more gaming activity options than any other state that has adopted internet casino gaming, and few states have adopted internet casino gaming. Factors that contribute to the indeterminate fiscal impact include the unknown volume of internet casino gaming, the extent to which current gaming activities could be reduced, and the impact on current Tribal payments to the MSF/MEDC. As a result, this analysis presents hypothetical projections of potential outcomes under the bill and what circumstances would be necessary to hold harmless current revenues for any displacement of existing gaming activity.

Under the bill, the tax rate would be based on the adjusted gross receipts. In calculating adjusted gross receipts, a deduction would be allowed. The deduction would decline from a maximum of 10% during the first three years the bill was in effect to zero by the sixth year. The tax rates would range from 20% for adjusted gross receipts less than \$4.0 million to 28% for adjusted gross receipts greater than \$12.0 million. The bill would distribute tax revenue based on whether the casinos hosting the online platforms were located in the City of Detroit

or on Tribal lands. [Tables 1](#) and [2](#) illustrate the amount of revenue generated estimated for a 5% and 10% increase from current casino gaming revenue after five years. The deduction initially would lower total revenue generated under the 5% scenario by \$33.0 million and \$5.7 million under the 10% scenario. The Tribal gaming revenue figures are based on current payments made by the tribes to the MSF/MEDC. However, it is important to note that each tribe is an independent entity, and when and if any given tribe would engage in internet gaming activity is unknown.

Table 1

Tax Revenue Distribution of Internet Gaming (in millions)				
	<u>5% Increase</u>		<u>10% Increase</u>	
	Detroit	Tribal	Detroit	Tribal
Adjusted Gross Receipts	\$72.2	\$48.0	\$144.4	\$96.0
Total Tax Revenue	\$18.2	10.8	\$38.4	\$23.6
Distribution:				
Local Revenue Sharing - Tribal	---	\$2.2	---	\$4.7
Michigan Strategic Fund	---	\$1.1	---	\$2.4
City of Detroit	\$5.5	---	\$11.5	---
Michigan Equine Fund	\$0.9	---	\$1.9	---
Internet Gaming Fund	\$11.8	\$7.5	\$25.0	\$16.5

Table 2

Internet Gaming Fund Revenue Distribution (in millions)		
	<u>5% Increase</u>	<u>10% Increase</u>
Total Internet Gaming Fund	\$19.3	\$41.5
Compulsive Gaming Prevention	\$0.5	\$0.5
First Responder Fund	\$2.0	\$2.0
School Aid Fund	\$11.8	\$39.0

As mentioned above, the degree to which internet gaming would substitute away from current brick-and-mortar casinos and the iLottery games is unknown. [Table 3](#) provides information on the potential loss to revenue from current gaming activity for 1%, 5%, 10%, and 20% of current gaming activity for brick-and-mortar casinos and iLottery. The reduction in revenue would affect the School Aid Fund, City of Detroit, MSF, and local units that receive revenue sharing payments from Tribal gaming. These reductions would offset any increases shown in [Tables 1](#) and [2](#).

Table 3

Potential Impact of Substitution Effects on Current Gaming Activity (in millions)						
Reduction	iLottery (SAF)	Casino (SAF)	City of Detroit	MSF	Local Units	Total
1%	(0.9)	(0.6)	(1.8)	(0.5)	(0.3)	(4.1)
5%	(4.7)	(3.2)	(9.1)	(2.7)	(2.7)	(21.2)
10%	(9.4)	(6.4)	(18.3)	(5.3)	(1.5)	(42.4)
20%	(18.8)	(12.8)	(36.6)	(10.6)	(6.0)	(84.4)

The bill likely would increase SAF revenue from the Detroit casinos-despite any substitution effects on brick-and-mortar casinos, because of the differences in the tax structure. Currently, roughly 39% of the 21% tax (the 18% casino gaming tax plus the 3% paid under the development agreements and subsection (7)) on current brick-and-mortar gaming activity goes to the SAF, which is 8.1% of adjust gross receipts. Under the bill, the SAF would receive roughly 60% (after the \$2.0 million deposit into the First Responder Presumed Coverage Fund and \$500,000 into the Compulsive Gaming Prevention Fund and administrative costs) of the new tax, totaling roughly 15% of adjusted gross receipts. As a result, gaming activity that moved from brick-and-mortar casinos to online gaming would be a net positive to the SAF. Additionally, because the tax rate for internet casino gaming would be higher than the current tax rate on brick-and-mortar casino gaming, there would be less incentive for casinos located in Detroit to move brick-and-mortar casino gaming towards internet casino gaming.

In contrast, substitution would result in a net reduction of iLottery revenue to the SAF, because currently roughly 69% of adjust gross receipts for lottery games goes to the SAF after operating expenses. As a result, internet casino gaming would need to generate over four times as much new gaming activity to hold the SAF harmless from any substitute reduction to iLottery games. However, iLottery only represents 18% of Lottery gaming activity in the State, which limits the overall potential decrease to the Michigan Lottery. The bill includes language to increase the distribution from the Internet Gaming Fund to the SAF if SAF deposited from iLottery games dropped below \$70.0 million. However, the Internet Gaming Fund deposits \$2.5 million in other funds and administration in the MCGB, the rest is already deposited into the SAF. This means that if revenue from iLottery games decreased significantly (more than \$2.5 million), there would be insufficient funds to support those losses to the SAF under the current distribution model.

While the City of Detroit would be held harmless for potential revenue declines, the relative tax rates and tax distribution formulas would require increases in internet casino gaming revenue in the City of Detroit casinos to be twice as large as any decreases from brick-and-mortar gaming activity. Consequently, the hold-harmless provisions likely would be triggered. The City receives roughly 61% of the 21% tax on current brick-and-mortar gaming activity, which is roughly 12.9% of total adjust gross receipts. Under the bill, the city would receive 30% of the new tax rate, which is roughly 6.9% of total adjusted gross receipts. As a result, casinos would need to generate half of internet casino gaming revenue from new customers to keep the City of Detroit harmless. The bill does include a provision that if payments made to the City of Detroit were less than \$183.0 million, the City would receive an increased portion of the tax revenue generated, up to 55% of the total. At the very extreme, this provision would maintain a one-to-one ratio of gaming activity moving from brick-and-mortar to internet casino gaming. However, whenever the hold-harmless provision was activated, the SAF would receive a smaller proportion of the tax revenue—meaning that the City would be held harmless at the expense of the SAF. In 2018, the City of Detroit received \$182.9 million from the three casinos located in the City of Detroit. The bill also is not clear which distributions from the tax revenue would be reduced first to support the City of Detroit.

Tribal casinos represent the greatest unknown factor when estimating the bill's impact. Tribal casinos make payments directly to the MSF/MEDC. Only six out of the 12 tribes make payments to the MSF/MEDC, ranging from 2% and 8% of relevant gaming activity. In FY 2017-18 the MSF/MEDC received \$53.4 million from the six tribes. If all tribes adopted internet casino gaming, the payments would increase to the MSF/MEDC, local units, and the SAF. However, there would be a net increase to the MSF/MEDC on internet casino gaming that substituted gaming activity from brick-and-mortar casino gaming if the tribe currently

contributes 2.8% or less, or in case of tribes that currently make no payments to the MSF/MEDC. The bill proposes 10.0% of the tax revenue from tribal gaming under the bill be paid to the MSF/MEDC. If a tribe's adjusted gross receipts were greater than \$12.0 million, the payments would equal a 2.8% tax on adjusted gross revenue, and shifts from brick-and-mortar casino gaming to internet casino gaming would be neutral. The payments from these tribes would be more reliable as the bill would require tribes to give up their sovereignty over gaming exclusivity, which has been the basis for tribes withholding payments to the MSF/MEDC in the past. However, the bill could result in additional tribes withholding payments to the MSF/MEDC because of exclusivity clauses in the compacts. Individuals could conduct online casino gaming from any casino directly on tribal lands, which hypothetically could violate those exclusivity clauses. If tribes withheld payments, the bill would have a significant negative impact on revenue to the MSF/MEDC, especially given that tribal payments make up nearly all of the MSF/MEDC corporate revenue. The corporate revenue pays for employees who supplement administration of various State economic development programs and provide additional economic development programs operated exclusively by the MEDC.

Any tribal internet gaming options would increase revenue sharing payments by tribes to local units of government. Even if a tribe generated less than \$4.0 million in adjusted gross receipts from online casino gaming, the revenue would be taxed at 20%, of which, 20% would be distributed to the local unit of government. This represents 4.0% of adjusted gross receipts, which is greater than the current 2.0% payment. As a result, any substitution from brick-and-mortar gaming activity to internet casino gaming would be a net positive to local units.

The bill would increase revenue to the Compulsive Gaming Prevention Fund by an additional \$500,000 million annually and to the First Responder Presumed Coverage Fund by \$2.0 million annually. These increases would be distributed from the revenue deposited in the Internet Gaming Fund. These payments would be made before administrative costs and the SAF deposit, which means that even if the hold-harmless provision for the City of Detroit disrupted the distribution of tax revenue, only the distribution to the School Aid Fund would be affected.

The bill would increase annual revenue to the AEIDF. Under the 5% and 10% hypothetical increases, the Fund would receive between \$900,000 to \$1.9 million annually.

The bill would create a new unit within the MGCB, which would increase administrative costs to the MGCB. The estimated costs currently are unknown, but the unit's responsibilities would include oversight, investigations, administration, and monitoring on internet casino gaming. The application and licensing fees would support these administrative costs. However, if the costs were greater than the revenue generated by the fees, the bill would allow the MGCB to use the tax revenue that is deposited into the Internet Gaming Fund after the \$2.5 million in distributions to other funds. However, this would limit the amount deposited into the SAF. Because the new unit's responsibilities include oversight of internet casino gaming, the information technology costs likely would be greater when compared to other units within the MGCB. The revenue collected from the fees should be sufficient to cover the administrative expenses.

Under the assumption of a net 5% increase in gaming activity, and a 5% substitution effect, and combined with the impact of House Bill 4916 (S-1), the bills would generate additional net revenue of \$17.8 million once the deduction phased out. However, accounting for the substitution effects and the distribution of net revenues, the bills would:

- Lower revenue to the MSF by approximately \$1.2 million.
- Increase local unit revenue to host communities by \$700,000.
- Increase revenue to the equine gaming fund by \$900,000.
- Lower revenue to the City of Detroit by \$1.8 million (excluding hold harmless provisions)

- Increase revenue to the Compulsive Gaming Prevention Fund by \$1.0 million.
- Increase revenue to the first provider presumed coverage fund by \$4.0 million.
- Increase revenue to the School Aid Fund by \$14.0 million.

If the hold harmless provisions pertaining to Detroit were triggered, revenue to the City of Detroit would be unchanged, but the increase in School Aid Fund revenue would be reduced to \$12.2 million.

These figures compare to the "mid-level" scenario estimates from the Michigan Department of Treasury, which also include the impact of House Bill 4308 (S-1), and predict the bills would:

- Increase revenue to the MSF by approximately \$3.0 million.
- Increase local unit revenue to host communities by \$3.3 million.
- Increase revenue to the AEIDF by \$1.6 million.
- Increase revenue to the City of Detroit by \$13.7 million.
- Increase revenue to the Compulsive Gaming Prevention Fund by \$1.0 million.
- Increase revenue to the First Provider Presumed Coverage Fund by \$4.0 million.
- Increase revenue to the School Aid Fund by \$4.8 million.

House Bill 4312 (S-1) would have no fiscal impact on local government and an indeterminate fiscal impact on the State, in light of the Michigan Supreme Court's July 2015 opinion in *People v. Lockridge*, in which the Court ruled that the sentencing guidelines are advisory for all cases. This means that the addition to the guidelines under the bill would not be compulsory for the sentencing judge. As penalties for felony convictions vary, the fiscal impact of any given felony conviction depends on judicial decisions.

House Bill 4323 (S-1) would have no fiscal impact on State or local government.

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