

GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2009

Legislative Fiscal Note

BILL NUMBER: House Bill 2030 (First Edition)

SHORT TITLE: Video Gaming Entertainment Act.

SPONSOR(S): Representative K. Alexander

FISCAL IMPACT (\$ in millions)					
	Yes (X)	No ()	No Estimate Available ()		
	<u>FY 2010-11</u>	<u>FY 2011-12</u>	<u>FY 2012-13</u>	<u>FY 2013-14</u>	<u>FY 2014-15</u>
REVENUES:	SEE ASSUMPTIONS AND METHODOLOGY				
State	\$384,700 to \$19.3 Million Annually				
Local	\$9.6 Million Annually				
EXPENDITURES (in Millions)	\$5.5	\$2.6	\$2.8	\$2.95	\$3
POSITIONS (cumulative):	36	36	36	36	36
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue and Department of Justice					
EFFECTIVE DATE: January 1, 2011					

BILL SUMMARY

HB 2030 creates G.S. Chapter 18D to allow video gaming for the purpose of profit sharing in the state of North Carolina. The bill defines video gaming as a computer terminal or other video display device used to reveal sweepstakes entries or play simulated games of chance with rewards.

Section 1

HB 2030 gives the Department of Revenue (DOR) the authority to issue video gaming permits annually. Upon issuance, these permits are required to be affixed to all approved video gaming machines (VGMs) to indicate that the machines have been registered, inspected, and approved for operation in North Carolina. The bill prohibits anyone other than authorized DOR personnel and/or the licensed operator from affixing or removing the permit. The bill also prohibits transporting a video gaming machine out of the state until the permit has been removed.

The bill prohibits a licensed operator from having more than 500 video gaming machines in the state to be played or operated at any one time.

Associated Fees

HB 2030 requires each approved applicant for an operator's license to pay an annual fee of \$5,000 and requires DOR to charge a licensed operator an annual fee of \$250 per VGM. Failure to pay the fee is grounds to revoke an operator's license. The bill entitles DOR to an administrative expense reimbursement of 4% of the fees collected under this provision. The bill directs that any remaining funds from the operator's license fees be remitted to the General Fund. Also, the bill directs any remaining funds from the VGM fees be disbursed to the county where the establishment is located or to the city if the establishment is located within the corporate limits of a city.

Restrictions and Additional Guidelines

HB 2030 allows a maximum of 10 VGMs to be located in any licensed establishment. Further, the bill also restricts a single wager on a VGM with a permit to no more than \$5.

The bill directs DOR to develop a model contract to be used between licensed operators and licensed establishments and provides that the contracts are to address IRS report requirements. The bill provides that the Unauthorized Substance Division of DOR is to have sole enforcement authority of G.S. Chapter 18D, and authorizes DOR to inspect a licensed establishment or licensed manufacturer at any time during normal business hours.

Sections 2 through 11

HB 2030 makes conforming changes to G.S. 14-292, 14-293, 14-296, 14-299, 14-301, 14-302, 14-304, 14-305, 14-306, and 14-306.1A.

Section 12

HB 2030 creates G.S. 114-19.26 authorizing the Department of Justice to provide any required information regarding the criminal history of any applicant for an operator's license or a licensed establishment to DOR and to its Director. The bill also provides for confidentiality of information and the charging of a background check fee.

Source: Bill Digest H.B. 2030 (05/25/2010).

ASSUMPTIONS AND METHODOLOGY:

REVENUE

HB 2030 legalizes video gaming machines (VGMs). It implements two VGM associated fees: 1) a \$5,000 licensing fee per operator to maintain VGMs in the state and 2) a \$250 per machine registration fee. Revenue from the first fee, the \$5,000 operator's license would be deposited directly into the General Fund. This fee gives each licensee the authority to operate up to 500 VGMs at a maximum of 10 VGMs per location. The second fee, a \$250 per machine registration fee, would be distributed by the Secretary of Revenue to local jurisdictions based on where the VGMs are operated. Both fees would be less a 4% withholding by the Department of Revenue to cover administrative costs.

A major provision in HB 2030 limits the number of video gaming machines to 10 per location. While the actual number of gaming machines remains unknown, this fiscal note focuses on prevalence of a similar activity, video poker, in North Carolina in 2001 to estimate the fiscal impact of HB 2030.

In 2000, the North Carolina General Assembly enacted legislation establishing new prohibitions, registration requirements, and reporting requirements for video poker machines. This act, S.L. 2000-151, also put in place new penalties for violating gaming laws.

S.L. 2000-151 required owners of existing VGMs to register with the North Carolina Sheriff's Association but banned any new video gaming terminals. The act also limited prize payouts to \$10 per eight plays and the number of VGMs to no more than three machines per location. A report to the 2001 General Assembly from the North Carolina Sheriff's Association identified 10,094 licensed and operating video gaming machines in the state.

Assuming that each retailer operated the maximum number of allowable machines in 2000, three terminals, Fiscal Research estimates that roughly 3,364 licensed establishments were positioned throughout the state (10,094 registered machines divided by three machines per establishment). Between 2001 and 2009, North Carolina's population increased by 14%. Adjusting the number of 2001 VGM licensed operators by population growth would increase the number of potential establishments from 3,364 to 3,847 establishments.¹ Thus roughly 38,470 machines would operate under the increased cap of ten machines per establishment provided by HB 2030 generating \$9.6 million in local revenue (\$250 per machine registration fee multiplied by 38,470 machines).

HB 2030 prohibits a licensed operator from having more than 500 video gaming machines operated in-state at any given time. Assuming there are 38,470 machines and that each operator were to operate the maximum number of allowable machines, 500 VGMs, Fiscal Research estimates that there would be 77 licensed operators statewide (38,470 estimated machines divided by 500 machines). However, if there were only one licensed operator per licensed location, there would be 3,847 licensed operators. Fiscal Research estimates that the total potential number of statewide operators would range from 77 to 3,847 licensed operators and would generate between \$384,700 and \$19.3 million in General Fund Revenue.

ADMINISTRATIVE COSTS FOR THE DEPARTMENT OF REVENUE

HB 2030 gives DOR the authority to issue operator's licenses and video gaming permits and inspect licensed establishments and VGMs, and further directs DOR to develop a model contract to be used between licensed operators and licensed establishments. DOR indicates that its current staff will not be able to absorb the additional workload required in order to administer HB 2030. To fulfill the requirements of the bill, DOR anticipates that it will need the following additional positions:

¹ The percentage change in North Carolina's population from 2001 (8,203,847) to 2009 (9,380,884) is 14.4%.
Source: North Carolina Office of State Budget and Management

- 6 Information Processing Technicians (IPTs) to provide administrative support, process license and permit applications, payments, and distributions.
- 24 Enforcement Agents to investigate illegal gambling activity, investigate machine permit tampering and transportation, conduct routine inspections of licensed establishments, evaluate variations of legal gambling activities submitted for approval, provide local law enforcement training, collect delinquent taxes due from video gaming operators, and inspect and permit temporary replacement machines due to servicing and repair.
- 8 Tax Auditors to conduct compliance reviews and annual audits of 5% of the video gaming operators.
- 1 Information Technology position to support and maintain any equipment requirements, software applications and databases required by DOR to administer Chapter 18D.
- 1 Staff Attorney to provide legal advice on policy and enforcement matters and to represent DOR in administrative and judicial proceedings. The attorney would be assigned to DOR but would be budgeted and administratively attached to the Department of Justice.

Fiscal Research concurs with DOR regarding the estimated need for one Information Technology position and one Staff Attorney. However, Fiscal Research does not concur with DOR's estimated number of positions for the IPTs, the Enforcement Agents and the Tax Auditors as detailed below.

Fiscal Impact Based on Montana Data

The Department of Revenue's cost estimate is based on statistics reported by Montana's Department of Justice Gambling Control Division. Although video gaming in North Carolina would operate much like retail gaming in other states, it appears that Montana's video gaming operations are the most comparable state to how North Carolina would operate under the passage of HB 2030. For example, video gaming in Montana is legal only in retail stores and other non-gambling establishments.

In Montana, 20,495 permits for VGMs were issued at 1,603 licensed establishments in 2008. Based on these figures, DOR anticipates that 6 Information Processing Technicians are needed to administer HB 2030 (20,495 permits, divided by 225 working days per year, divided by 15 to 16 permits reviewed daily per employee). DOR also anticipates that 24 Enforcement Agents are needed to administer HB 2030 (20,495 permits, divided by 225 working days, divided by 3 to 4 machines inspected daily per employee). As North Carolina was 9.5 times more populous than Montana in 2008, DOR estimates that 8 Tax Auditors are needed to administer HB 2030 (5% of 10,000 licensed operators, divided by 62.5 audits per year).²

²DOR multiplied 9.5(North Carolina to Montana population ratio) by 1,603 (the number of licensed locations in Montana) to estimate the number of potential licensed operators in North Carolina. The outcome predicts 15,228 licensed operators, but DOR based its calculations on a more conservative estimate—10,000 licensed operators. Also, DOR estimates that a Tax Auditor would be able to complete 62.5 audits of licensed operators per year.

In total, DOR estimates that it will need \$6,146,383 for 39 positions and DOJ estimates that it will need \$90,823 for one staff attorney position in FY 2010-11.

Fiscal Impact Based on North Carolina Historical Data

Although Montana's video gaming operations are similar to what is proposed in HB 2030, there are also significant differences that require further analysis when calculating North Carolina's estimated costs. For example, HB 2030 would cap the number of VGMs at 10 per location, whereas Montana caps the number of VGMs at 20 per location. Competition from neighboring states and cultural factors also differentiate North Carolina from Montana. Further, North Carolina was 9.5 times more populous than Montana in 2008. Thus, it is also important to review historical information on VGMs in North Carolina as a basis for predicting licensing and permit numbers.

As previously discussed in this analysis, the 2001 North Carolina Sheriff's Association report identified 10,094 licensed and operating VGMs in the state. Fiscal Research estimates that roughly 3,364 retailers operated VGMs in 2001 (10,094 registered machines divided by the maximum of three machines per retailer). Assuming that the number of retailers increases by the exact percentage change in North Carolina's population from 2001 to 2009, there would be 3,847 retailers under the passage of HB 2030.³ If 3,847 retailers were to operate the maximum number of allowable VGMs, 38,470 machines would operate under the increased cap of ten machines per establishment.

Based on this historical data, Fiscal Research estimates that DOR would require 12 Information Processing Technicians to administer the bill (38,470 permits + 3,847 operator applications, divided by 225 working days per year, divided by 15 to 16 applications reviewed daily per employee). Fiscal Research also anticipates that DOR would require 19 Enforcement Agents to administer the bill (38,470 permits, divided by 225 working days, divided by 9 machines inspected daily per employee).

DOR audits 5% of tax returns annually and anticipates auditing 5% of licensed operators each year. As shown previously in the analysis, Fiscal Research estimates that there could be 77 to 3,847 licensed operators. Fiscal Research estimates a requirement of 3 Tax Auditors (5% of 3,847 licensed operators, divided by 62.5 audits per year).⁴ If on the other hand there are as few as 77 licensed operators, the Tax Auditors' workload would be substantially less.

As a caveat, the estimated time that it takes to review a permit, conduct an audit and compliance review, and inspect a machine is based upon statistics reported by Montana. It is possible that these estimated times may change under the regulations of HB 2030. However, a year's experience of administering the bill will reveal actual workload requirements.

In total, Fiscal Research estimates that DOR will require \$5,442,175 to support 35 FTEs and DOJ will need \$90,823 for a staff attorney position in FY 2010-11. Table 1 summarizes the total fiscal impact estimated by Fiscal Research (see page 6).

³ The percentage change in North Carolina's population from 2001 (8,203,847) to 2009 (9,380,884) is 14.4%. Source: North Carolina Office of State Budget and Management

⁴ DOR estimates that a Tax Auditor would be able to complete 62.5 audits of licensed operators per year.

Table 1. Estimated Cost to Administer HB 2030 in FY 2010-11	
Description	Estimated Cost
Information Processing Technicians	12 Positions
Salary	\$449,598
Benefits	\$140,689
Enforcement Agents	19 Positions
Salary	\$862,828
Benefits	\$293,482
Tax Auditors	3 Positions
Salary	\$141,447
Benefits	\$40,474
Information Technology Position	1 Position
Salary	\$88,593
Benefits	\$21,017
Staff Attorney (DOJ Expense)	1 Position
Salary	\$69,000
Benefits	\$17,460
IT Services	
Telephone Service	\$21,370
Maintenance Agreement - PC	\$8,365
Maintenance Agreement – PC Software	\$4,025 NR
PC Purchases	\$35,000NR
Printer Purchases	\$9,620 NR
PC Software Purchases	\$21,000 NR
Infrastructure Costs	\$2,718,218 NR
Maintenance on Infrastructure	\$100,000
Administrative Services	
Supplies	\$17,500
Employee/Employment Physical	\$5,225 NR
Rent/Lease-Buildings/Office	\$180,000
Transportation – Ground – In State	\$114,000
Lodging – In State	\$19,000
Meals – In State	\$19,000
Clothing & Uniforms	\$ 6,175 NR
Furniture Office	\$ 74,375 NR
Equipment (Calculator)	\$ 3,400 NR
Equipment –Voice Communications (cell)	\$ 855 NR
Custody & Security Equipment	\$ 47,500 NR
Research/Devt. & Educational (DOJ expense)	\$700
Travel (DOJ expense)	\$2,400
Furniture Office (DOJ expense)	\$1,500 NR
TOTAL COST	\$5,532,998
TOTAL FTEs	36
* Benefits for each position include social security, retirement, and health insurance.	

Operational Expenses

DOR uses the Department's standard costs to estimate the operating expenses that would be required to administer HB 2030. DOR budgeted \$4,500 per employee for the cost of a workstation cubicle. Based on statistics reported by the Program Evaluation Division, Fiscal Research estimates that DOR will only need \$2,125 per employee for the cost of a workstation cubicle. Excluding infrastructure costs, all other estimates projected by DOR appear to be reasonable.

With respect to infrastructure costs, DOR estimates that it will need \$3.2 million. DOR plans to use a centralized computer system for reporting income and for monitoring VGMs. This centralized system requires a new system for communication, security, storage, increased bandwidth to network, network components, and encryption lines. DOR estimates that it will need storage for 100,000 VGMs. As shown previously in the analysis, Fiscal Research estimates that DOR will only need storage for approximately 40,000 VGMs.

In addition, the software costs estimated by DOR are based on current ITS costs. However, these expenses may be lower if the licenses to the Oracle software are purchased directly from the Information Technology GSA schedule. In total, Fiscal Research estimates that DOR will need \$2.7 million for infrastructure costs.

Administrative Expense Reimbursement

HB 2030 requires each applicant for an operator's license to pay an annual fee of \$5,000 and each licensed operator to pay an annual fee of \$250 per VGM. The bill entitles DOR to an administrative expense reimbursement of 4% of the fees collected. If there were 3,847 licensed operators and 38,470 VGMs, then DOR would be reimbursed \$1,154,100 annually (4% of the following: \$5,000 multiplied by 3,847 operators, plus \$250 multiplied by 38,470 VGMs).

ADMINISTRATIVE COSTS FOR THE DEPARTMENT OF JUSTICE

HB 2030 directs the Department of Justice (DOJ) to conduct background checks on applicants for an operator's license and on any partner, director, officer, or stockholders. The bill requires these persons to pay any required fees for the criminal record check. Since there is a cost recovery mechanism in the bill, DOJ does not anticipate any fiscal impact with respect to conducting background checks.

As previously mentioned in this analysis, DOJ anticipates the need for 1 Staff Attorney to provide legal advice on policy and enforcement matters to DOR. The Staff Attorney would also represent DOR in administrative and judicial proceedings. The attorney would be assigned to DOR but would be administratively attached to DOJ.

The total operational impact of this legislation on the Department of Justice for FY 2010-11 totals \$90,823 and 1.0 FTE (see Table 1 on page 6).

SOURCES OF DATA:

Source: Arduin, Laffer & Moore Econometrics, “The Estimated Revenues from a New Video Gaming Tax in Illinois,” July 2009, <http://thecapitolfaxblog.com/EstimatedRevenuesfromgaming.doc> (accessed March 3, 2010).

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West Virginia Gaming, 2009 Annual Report, <http://www.wvGaming.com/pdf/WVL2009AR-hr.pdf>, (accessed March 5, 2010).

Maryland Department of Legislative Services, Office of Policy Analysis, “Legislators’ Guide to Video Gaming Machine Gambling,” January 2004, http://mlis.state.md.us/other/Fiscal_Briefings_and_Reports/00_Leg%20Guide%20to%20VGM%20Gambling.pdf, (accessed March 16, 2010).

TECHNICAL CONSIDERATIONS:

HB 2030 requires each applicant for an operator’s license to pay an annual fee of \$5,000. Fiscal Research is assuming that this fee pertains only to those applicants who are awarded a license.

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