

Gaming Tax – Scope and Feasibility

Date:	September 22, 2008
To:	Executive Committee
From:	Deputy City Manager and Chief Financial Officer City Solicitor
Wards:	All
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SUMMARY

The purpose of this report is to provide information to the Executive Committee with regard to a Motion requesting a report on the feasibility of establishing a Gaming Tax in the City of Toronto, in accordance with the Executive Committee's Decision Advice at its meeting on April 7, 2008.

A gaming tax could theoretically be structured as: (1) a tax on gambling winnings, (2) a tax on the activity of placing a wager or purchasing a lottery ticket, (3) a tax on the price of admission to an establishment where gambling activities occur, or (4) a tax on gaming operators, such as a tax per slot machine.

The three main gaming activities in Toronto are lotteries, race track betting, and slot machines. Lotteries are characterized by numerous games, high volume and widely distributed transactions of nominal value. Consequently, taxing related wagering activities would be relatively costly for the City and the sellers to administer. Taxing the winnings of Toronto residents (such as above an established value threshold) could be considered, but may be difficult to enforce, is not the current practice in Ontario, and so may result in a strong negative reaction from the public. Furthermore, the net proceeds from lotteries are already directed to public purposes by the Provincial government, so a new tax would be less efficient than a direct revenue sharing arrangement.

Racetrack betting in Toronto occurs at Woodbine racetrack and at various licensed off track betting facilities throughout the City. A tax on these activities (winnings or wagers – admission prices are generally nil) should be reasonable to administer. At the time of writing this report, the potential tax revenues are not known. Some downside

considerations are that such a tax could skew the gaming market unintentionally toward lotteries and drive off track betting business activity out of the City.

Operation of slot machines in the City of Toronto is currently licensed only at the Woodbine Racetrack. The City and the Province have a revenue sharing agreement related to the revenues from the slot operations at this facility. The City has on numerous occasions sought a higher share of the proceeds from the Province to no avail. However, the Province may be more agreeable to a City tax as it would have less impact on its own revenue stream, and place the responsibility for the tax squarely on the City.

Any new gaming tax is likely to increase the trend toward illegal internet gaming activity in the City.

A City gaming tax on winnings or wagering would likely not be feasible under the current provisions of the *City of Toronto Act, 2006* (COTA), as sales taxes and income or wealth based tax are currently excluded from permitted taxing activities. A City request for legislative change to facilitate a gaming tax could be included in the statutory process for a two year review of the COTA. However, a new City tax would inevitably conflict with provincial revenue and policy objectives and a request for change is therefore likely to meet resistance.

Financial Impact

This report is for information only, and there are no direct financial impacts. The potential gaming tax revenue for the City depends upon legislation, and would vary by the form of tax (i.e. lotteries, racetracks etc.) and the tax rates.

DECISION HISTORY

City Council at its meeting of January 29 and 30, 2008 referred a Motion M16.7 to the Executive Committee for its consideration. The Executive Committee, at its meeting on April 7, 2008, considered the Motion and advised as follows:

“The Executive Committee referred the Member Motion by Councillor Palacio, seconded by Councillor Moscoe to the City Solicitor and the Deputy City Manager and Chief Financial Officer with a request that they submit a report to the Executive Committee on the ways in which a "Gaming Tax" could be imposed legally, how its collection could be administered and if these methods are feasible.”

BACKGROUND

COTA provided the City for the first time the power of direct taxation, subject to prescribed limitations. In 2007 Council considered a range of options and directed staff to implement two new taxes under these powers: Municipal Land Transfer Tax (MLTT) and Personal Vehicle Tax (PVT).

Subsequently a Council motion directed staff to review its options to implement a gaming tax. This report presents a preliminary review of the legal options and practical

considerations for such a tax (Appendix A provides a legal framework, Appendix B provides policy considerations and Appendix C provides administration and design considerations).

The Act provides authority for the City to impose a direct tax within the City. Subsections 267(1) and 267(3) provide that the City may impose a tax provided that the tax is a direct tax and that the City's by-law satisfies certain content requirements.

Direct taxation means a tax which is demanded from the persons who ultimately bear the cost (e.g. sales tax at retail level), either by taxing the ultimate consumer of the product or by taxing in such a way that the tax is not related to a unit of a commodity or its price in the course of the unit being manufactured or marketed. To contrast, an indirect tax is one which is demanded from one person in the expectation that it will be recovered from another (e.g. federal tax in LCBO price). Furthermore, direct taxes are not fees, which are legally defined as charges imposed on users of a service to recover the costs of providing that specific service. The fees and charges sections of the COTA are basically unchanged from previous legislation.

COTA imposes prohibitions on the City's direct taxation power including specifically prohibiting the City from imposing an income tax, sales tax and/or a tax on wealth.. The City is also prohibited from imposing a tax on various entities including the Province, and Crown corporations and agencies.

The Province is required to undertake a review of the powers within COTA after 2 years i.e. beginning in January 2009, which it is not required to do again until 2014. City staff could submit a request for changes to its taxing powers as part of this review.

COTA leaves it up to the City to identify and implement other direct taxation measures as it sees fit. The Province retains the power to further prescribe through regulation limits on the City's powers to impose new taxes.

COMMENTS

1. Gaming Market in Toronto

Gambling is an important growth industry in Canada, providing significant revenue to governments, charities, retailers and business providers. Gambling is largely seen by Canadians as a socially acceptable activity and many new games have been introduced in Canada over the last decade to increase revenue and meet player demands. Technology has played a role in the expansion of gambling in Canada. In recent years, various provinces have introduced games such as electronic keno, computer bingo and video-based slot machines to increase the attractiveness of gambling.

Gaming is regulated, administered and operated under the Ontario Lottery and Gaming Corporation in Ontario. There are various forms of gaming/gambling permitted by law, including:

- Lotteries and scratch-off games;
- Horse racing (e.g. Woodbine in Toronto);
- Slot machines at racetracks;
- Off track betting (including sports activities such as hockey/football, horse racing, and dog racing via teletheatres);
- Commercial and charity casinos with slot machines and table games such as roulette, poker and blackjack;
- Bingo;
- Private bets between individuals who are not engaged in the business of betting under section 204 of the Criminal Code;

Gaming that is not permitted in Ontario includes:

- Video lottery terminals;
- Internet gambling (despite this fact, one of the most important new trends to affect the gaming industry is internet gambling).

2. Taxing Gaming Activities

The Province of Ontario licenses and operates lotteries and casinos through its crown corporation Ontario Lotteries and Gaming Corporation, and is a beneficiary of the proceeds net of winnings. Nonetheless, the Province considered taxing lottery and casino winnings in April, 2004 [per CTV.ca News Staff, April 29, 2004]. Taxing jackpots (on lottery tickets, casino wins and even horse racing) was one of the most popular ideas put forward by a focus group of 250 Ontarians, who were asked to recommend ways to raise money without raising taxes. Some gambling winnings by Canadian residents in the U.S.A. are taxed in Canada (gambling or lottery winnings, but blackjack, baccarat, craps, roulette, and Big-6 wheel are exempt from tax).

Almost all U.S. states now obtain significant tax revenues from the gaming activities within their jurisdictions. The Casino Association of New Jersey claims that \$1.1 billion in tax revenues are generated each year from the casino taxes, luxury tax and other taxes related to casino operations. The gaming revenues collected by or directed to cities are not as easy to identify. However, the City of Reno, Nevada indicates in its website that 2007/08 city revenues from gaming fees (a flat fee based on the number of gaming devices on a property) contribute a portion of the nearly \$20 million collected from business, gaming and liquor licensing and permits.

In Toronto, there are no commercial casino operations with the exception of the Woodbine Racetrack facilities slot machine operations, which as discussed earlier is subject to a revenue sharing agreement with the Province. City Council has considered seeking a casino and has not adopted a formal request to the Province in this regard. Therefore, taxing of casino operations may have limited utility in Toronto. A flat per machine tax on the 1,900 gaming machines at the Woodbine Racetrack, similar to what is done in Reno, would not be feasible because the City cannot tax the Crown or its agents

including the Ontario Lotteries and Gaming Corporation which runs the Woodbine gaming machines.

3. Preliminary Assessment of Options

Without figures on the amount of gate proceeds, funds wagered or winnings, and estimates of the price elasticity of these figures, the gross dollar proceeds of a new tax cannot be calculated. A study of local gaming activities and comparable gross and net proceeds in other jurisdictions would be the next step if the City decides to pursue this taxing option further.

However, this preliminary review of the characteristics of local gaming leads to the following conclusions.

(a) Charities (including Bingo and lotteries) & Lotteries (e.g. O.L.G.C. administered lotteries)

Both charitable bingo/lotteries and Lottery and Gaming Corporation lotteries serve social purposes. The proceeds are currently used for charitable or public purposes. Taxing these activities therefore could be perceived as counter to the public service objectives of the City, and might be vigorously opposed by these charities and the Province of Ontario. Aside from legal concerns, taxing the significant winnings of these lotteries would be difficult to enforce as winners of major purses could be capable of establishing an address outside of Toronto to avoid the tax. Taxing modest winnings of lotteries could be seen as a tax on the poor. These gaming activities are also characterized by high volume but low value transactions, which are typically the least efficient activities to tax.

(b) On-track and off-track betting – betting tax

The facilities result in revenue for the operators and for the Province of Ontario. At some level of taxation there would be measurable impacts on the gaming market activity in Toronto, possibly shifting to legal non-taxed gaming, gaming sited outside Toronto, and/or illegal internet or other illegal gaming activities. Concerns about these impacts would no doubt trigger opposition from operators, and possibly from the Province of Ontario. To the extent that operators relocated outside Toronto over time, the City's property assessment base could be impacted.

It should be noted that the City has recently approved a property tax concession for a redevelopment plan around the Woodbine Racetrack by a consortium including the racetrack operators. A new tax would partially claw back the tax concessions that City recently approved.

(c) Casinos

There are no commercial casinos currently operating in Toronto except the Woodbine Slots Facility at the Woodbine Racetrack, which is subject to a revenue sharing agreement with the Province of Ontario, designed to offset certain program costs experienced by the City related to the facilities operation. The City has repeatedly attempted to have its share of revenues increased, to no avail.

(d) Tax on admissions

An amusement sales tax on admissions to gambling facilities could be feasible if admission charges were the norm. Woodbine Racetrack reports that for several years it has not had an admission fee and off-track betting sites generally do not charge admission. Even if these locations did charge entrance fees, the amount of potential tax revenue would be small in comparison to bets and winning.

As a result of these policy and administrative considerations, it would appear that taxing racetrack related gaming facilities holds the most potential for a new gaming tax, although the revenue potential has yet to be quantified. However, as mentioned in the report, the City does not currently appear to have clear legal authority to implement such a gaming tax. If the City were to obtain the necessary amendments to the City of Toronto Act, such a tax would still have important market, economic development and intergovernmental impacts that would require further study and consultation before a final decision to implement.

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ATTACHMENTS

Appendix A: Legal Framework

Appendix B: Policy Considerations

Appendix C: Administration and Design Considerations

Appendix A Legal Framework

A gambling tax could potentially be structured in one of the following ways, the authority for each of which is examined below:

1. a tax on gambling winnings;
2. a tax on the activity of placing a wager or purchasing a lottery ticket; or
3. a tax on the price of admission to an establishment where gambling activities occur;
4. a tax on the gaming operator.

1. Tax on Gambling Winnings:

The taxation by the City of gambling winnings is arguably prohibited by paragraph 1 of subsection 267(2) of COTA which provides that the City is not authorized to impose a ‘tax on a person in respect of the person’s income, revenue, profits, receipts or other similar amounts’.

Windfall earnings from gambling activities are not subject to income tax in Canada. Pursuant to section 40(2) of the Canadian *Income Tax Act* taxpayer’s gains and losses from the disposition of the following are deemed to be nil:

- a chance to win a prize or bet.
- a right to receive an amount as a prize or as winnings on a bet, in connection with a lottery scheme or a pool system or betting referred to in section 205 of the Criminal Code.

The prohibition on the City’s authority to impose an income tax under paragraph 1 of subsection 267(2) is not linked to whether such “income, revenue, profits, receipts or other similar amount” is taxable under the *Income Tax Act*. The fact that such winnings are not subject to federal and provincial income tax is not determinative of whether the City is permitted to tax them. Rather, it would appear that gains from such winnings would be taxable under the *Income Tax Act* were it not for subsection 40(2) which explicitly provides that winnings have a value of nil for the purpose of calculating income tax on such gains. Similarly, pursuant to the same section gambling losses cannot be deducted from gambling gains for the purpose of income tax calculation. This exclusion from taxation is likely driven by the minimal tax revenue which would be derived from gambling gains as offset by gambling losses.

It is arguable that winnings would fall into the ordinary meaning of the words “income, revenue profits, receipts or such other similar amounts” as these words are very broad in scope. While income tax case law in Canada has largely excluded windfall gains from income, family law case law, for example, has taken a different interpretation of the word “income” by usually including gambling winnings in income for the purpose of maintenance and support.

Accordingly, paragraph 1 of subsection 267(2) of COTA, in its broad prohibition of a tax on any form of income, revenue, profits, receipts or other similar amounts may have the effect of prohibiting the City from imposing a tax on windfall earnings from gambling activities despite windfall earnings not being taxable pursuant to the *Income Tax Act*, making such a City tax vulnerable to successful challenge.

2. Tax on placing a wager:

Paragraph 5 of subsection 267(2) of COTA provides that the City is not authorized to impose a “sales tax on a person in respect of the acquisition or purchase of any tangible personal property, any service or any intangible property”.

A “sale” has been defined by the courts as:

The action or an act of selling or making over to another for a price; the exchange of a commodity for money or other valuable consideration.

And a sales tax is defined by the Dictionary of Canadian Law as,

The tax imposed under Part IX of the *Excise Tax Act* and taxes levied under Acts of the legislature or a province in respect of supplies of property or services.

A tax imposed on the placing of a wager resembles a sales tax if it is payable at the time of the placing of the wager, is payable to the person with whom the wager is placed, is payable upon all wagers placed within the City of Toronto, and if the placing of a wager is either tangible or intangible property or a service.

Pursuant to section 187 of the *Excise Tax Act*, the purchase of an opportunity to win at “a game of chance, a race or other event or occurrence” is taxable for GST purposes, with the person with whom the bet is placed being treated as having supplied a service to the person placing the bet. A “game of chance” is defined by the *Excise Tax Act* as “a lottery or other scheme under which prizes or winnings are awarded by way of chance or by way of a mixture of chance and other factors where the result depends more on chance than on the other factors”. Certain exemptions exist for bingos, casinos and similar activities run or sponsored by charitable or non-profit organizations, and for betting on horse racing. Horse race betting, however, is taxed in Ontario under the *Race Tracks Act*.

As the act of placing a wager constitutes the acquisition of a service for the purpose of both the *Excise Tax Act* and the *Race Tracks Act*, a tax imposed on the placing of a wager falls within the definition of a sales tax. As a result, the City is likely prohibited from imposing a tax on the placing of a wager by paragraph 5 of subsection 267(2) of COTA as a sales tax.

3. Tax on Admission to a Gaming Establishment:

An exception is made by subparagraph 5(i) of subsection 267(2) of COTA to the sales tax prohibition for a tax imposed on a person “for the purchase of admission to a place of amusement as defined in the Retail Sales Tax Act.”

The Retail Sales Tax Act defines a “place of amusement” as:

“an amusement park or a premises or place, whether enclosed or not, where ... a ... horse race ... or other entertainment is staged or held, ... and to which admission is granted upon payment of a price of admission through the sale of tickets or otherwise”.

Accordingly, a City tax on the price of admission to a horse racing establishment is authorized by COTA. Similarly, as other forms of gaming activities likely fall under the general category of “other entertainment”, a City tax on the price of admission to any such establishment is likely also permitted.

However, this power may be of limited use in the gaming context as most gaming establishments are unlikely to charge a price for admission to the premises as they derive most of their revenues from the gaming activities themselves.

4. Tax on Gaming Operators:

The City’s power to impose taxes under section 267 is limited to direct taxes within the City. Accordingly, it could only be imposed on gaming operators operating within the City of Toronto, and must be imposed in such a way as not to be directly passed on to the person placing the wager.

Furthermore, Crown corporations such as the Ontario Lotteries and Gaming Corporation would be exempt from any such tax.

Appendix B Policy Considerations

The following considerations have been identified to help evaluate the potential for new taxing options under the City of Toronto Act:

Market Elasticity: What impact would a new tax have on the amount of gaming activity subject to the tax? How responsive is the marketplace to an increase in the transaction cost?

Market Distortion: Would taxing one form of game (e.g. on-track and/or off-track betting) and not another (e.g. lotteries run by O.L.G.C.) unfairly distort the market balance?

Market Avoidance: Would taxing one form of game (on-track and/or off-track betting at fixed location sites) encourage gambling and its operators to move out of the City or encourage increased illegal internet-based gambling?

Policy Fit: Would a City gaming tax help deter problem gamblers from participating in gambling activities? Help fund City programs that support the families of problem gamblers? What impact would a tax have on tourism?

Impact on Public Revenues: Would a City gaming tax have an adverse impact on the provincial revenues from various forms of gambling in Toronto or on City property tax revenues from related assessment?

Exemptions: What gambling activities should not be taxed (e.g. charitable organizations, nominal winnings, etc.)

Use of Proceeds: How would a new gaming tax revenue be utilized?

Appendix C

Administrative and Design Considerations

The following administrative and design issues are representative of the issues that need to be addressed if a tax is to be implemented:

Taxable Activity: Which form of gaming/gambling activities should be taxed? What specific activity (winnings, wagers, or admissions) should or can be taxed?

Tax Revenues, Tax Rate: What should be the level of taxation (e.g. a flat admission fee; a percentage of funds wagered; winnings (subject to legislative change) from tractable gambling activities, such as slot machines, programmed to deduct a City gaming Tax)? How much revenue might be expected?

Cost of Administration: How would the City's gaming tax be collected, reported and audited? Who would administer/coordinate the collection and at what cost? How does this compare to the expected revenues? Is this an efficient way to raise new revenues?

Compliance: What enforcement measures would need to be taken, if required (e.g. suspension of gambling operation licence/fines/penalties) and by whom if City gaming tax revenues were not submitted? What avoidance opportunities are there and how difficult is it to control them?