FUTURE OF GAMING IN TASMANIA

Stage 2 Public consultation

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EGM Electronic gaming machine

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NGO Non-Government Organisation

SEIS Social and Economic Impact Study

TLGC Tasmanian Liquor and Gaming Commission

Introduction

This paper is a response to the invitation to address the implementation of the Government's FGM policy via the proposed *Gaming Control Amendment (Future Gaming Market) Bill 2021*.

Given the Bill requires legislative approval it is incumbent upon all involved in that process to fully understand the proposals. Fact sheets have accompanied the proposed amendments. At best they only provide modest assistance. Understanding the existing system is a fundamental prerequisite for assessing the possible effects of proposed changes.

The aim of the Future Gaming Market FGM policy is to:

- create a sustainable industry;
- provide the highest standards of probity;
- ensure returns from the gaming industry are shared appropriately among the industry, players and the Government representing the community; and
- continue to minimise harm caused by problem gambling.

It's the third of these aims, that returns are shared appropriately which is the focus of this paper The comments need to be viewed against a backdrop of the State government's fiscal sustainability challenges and policies for industry development across sectors. The inescapable nagging question that needs to be answered is why does an industry with as few redeeming features as the gaming industry receive gold star government assistance?

Executive summary

- Existing gaming arrangements in pubs and clubs are about to expire. Operators have recouped investment in gaming facilities many times over.
- The government is proposing to gift a new system of EGM rights to existing operators. Any taxes that need to be paid will reduce the value of the gift. However, the burden of taxes is borne by players. It is the government/community's right, in fact responsibility, to determine what is appropriate. Current operators do not have any inalienable or residual rights to dictate the size of the gift. That would be akin to allowing a spoiled child to bully Santa.
- EGMs in pubs and clubs are currently very profitable, much more than food and beverage operations which supposedly complement gaming.
- There is no economic basis for allowing venues to more than double their profits from gaming when they are already highly profitable. The best performing EGM venues, the nine pubs in the top decile, would have averaged net profits of $1.026 million from EGMs based on 2020/21 player losses had the proposed FGM rates applied.
- The next best use principle should be used as a benchmark to determine an appropriate share for pub EGMs. The normal rate of profits from food and beverage operations from the space occupied by 30 EGMs (which most pubs have) would be approximately $60,000 per annum.
- The top 30 per cent of pubs will still get 70 per cent, but of a much larger pie. The bottom 30 per cent of venues will still get a 5 per cent share. Profits for all will increase enormously. Once break-even is reached pub profits will increase by 42 cents for every $ of player losses compared to 20 cents currently.
- Stepped tax rates with grouping provisions will restore fairness needed in a system that has grown into an unbalanced money operation for the benefit of a few.
- As an alternative to stepped tax rates, or perhaps as a complementary measure, super profits could be clawed back via EGM licence fees which will be set by Regulation, allowing the community to share returns from gaming more appropriately.
- The government is yet to identify any spill over benefits for the rest of the economy which may justify participants in a highly regulated government mandated activity earning super profits.
- An EGM licence, backed by a government mandated revenue stream is a very valuable asset. The longer the term of the expected income stream

the more valuable the asset. Perpetual licenses will give operators huge windfall gains. The capital value of pubs attributable to EGMs as a result of FGM is estimated to be $219 million.

- The gambling industry says profits earned by venues will be reinvested back into local communities to make them stronger. Giving untied grants is a policy without merit. Providing untied handouts in perpetuity would be reckless.
- Love Your Local was a marketing slogan that helped win the 2018 State election. It’s unlikely to be invoked as a guiding principle when cashed up aggregators looking for suitable milking cows come knocking on the door trying to gain access to government mandated revenue streams.
- Players have largely been forgotten. The best way to give players a more appropriate share is to slow down spin speeds, reduce maximum bet limits, increase the returns to players and remove the addictive features of EGMs which prey on vulnerable players
- The proposed FGM changes can easily be enhanced by offering low impact EGMs as part of minimising harm from problem gambling, with a separate regimen of tax rates and license fees to incentivise the shift.
- Tax and CSL should be viewed as one as being the returns to government. How those returns are spent is a separate issue, whether to hypothecate via a CSL or make them subject to the normal appropriation procedures.
- Gambling taxes share many of the same characteristics as GST. Whilst an EGM operator may collect and remit both taxes, the economic burden of the taxes falls squarely on players. Operators may remit the taxes, but it’s the players who pay them.
- There is no economic basis for giving Federal Hotels a tax concession of S16.4 million for EGMs which for historical reasons happen to be in casinos. It’s locals who incur virtually all losses. Any concession simply gives Federal Hotels an unfair advantage over other providers in the increasingly competitive accommodation market in Hobart and Launceston.
- The tax rate for Keno in pubs and clubs is much lower than for EGMs when the net profit percentage is likely to be considerably higher. Keno is a de-facto lottery where losses are taxed at 80 per cent.
- The unjustifiably low rate of tax, less than one per cent, proposed for Keno in casinos highlights the dog’s breakfast nature of the entire suite of proposed FGM changes. It is impossible to discern consistently applied

principles which should underpin all public policy decisions, let alone one with such far reaching and long lasting effects as FGM policy.

EGMs in pubs and clubs

There are currently 93 venues with 2,305 EGMs. Six (6) clubs have 97 EGMs. The remaining venues are pubs. Fifty (50) pubs each have 30 EGMs, the maximum permissible. The remaining 37 have 708 in total, varying between 10 and 25 EGMs per venue.

The government released fact sheets used 2018/19 turnover figures to explain the impact of the proposed FGM changes. NB Turnover **equals** player losses. The 2020/21 player losses have since been released by the TLGC and these will be used to explain the existing situation and the impact of FGM changes.

Under current arrangements venues receive a commission equal to 30 per cent of player losses from Network Gaming (NG), the licensed operator. Any taxes are paid by NG. Venues incur fixed costs (EGM hire fees/promo levy) of approximately $4,500 per EGM plus variable costs (wages, electricity etc) of approximately 10 per cent of player losses. A snapshot of venues' P&L from EGMs is as follows:

Profit & Loss EGMs in Pubs Existing

	$ m
Player losses	117.3
Commission (30%)	35.2
Less	
Fixed costs	10.4
Variable costs	11.7
Net profits	13.1

Most venues offer gaming alongside the normal suite of products in the pub game: Bottle shops, bars, food and accommodation. Accommodation is not the primary focus for most EGM venues, some don't offer any. Most are traditional style pubs where accommodation is a sideline at best. Gaming is by far the most lucrative use of floor space in these venues. If instead of gaming, the floor space was used as part of food and beverage businesses, net profits would be considerably lower. Taking a line through the profitability of the food and beverage sector in the hospitality industry, net profits of $4.6 million would be a reasonable estimate of profits from areas currently devoted to EGMs. This means $60,000 from the area occupied by 30 EGMs. In other words, 'normal profits' of $4.6 million. This leaves the balance of $8.5 million as the current super profits from EGMs in the community.

EGMs in pubs and clubs are currently very profitable, much more than the complementary food and beverage operations of the hospitality industry.

Before delving deeper into how this is distributed between venues it may be opportune to look at how the proposed FGM changes will impact profits overall.

Profit & Loss EGMs in Pubs Proposed

	$ m
Player losses	117.3
Less taxes	
GST	10.7
State taxes	45.6
Losses retained	61.0
Less	
Fixed costs	20.1
Variable costs	11.7
Net profits	29.2

Under proposed FGM changes player losses will be received by each venue. GST and State gambling taxes will need to be paid by venues. After fixed and variable costs, venues will be left with net profits of $29.2 million based on 20/21 player loss figures. Net profits from EGMs in pubs will rise by $16.1 million or 123 per cent. Although facing a higher level of fixed costs (variable costs such as wages etc will be the same), the increased revenue means venues will retain 42 cents in every $ lost by players compared to the existing situation of 20 cents in $.

> There is no economic basis for legislating to allow venues to more than double their net profits from gambling when they are already highly profitable.

Perhaps there's some inequities across venues that FGM proposal need to address? To answer this, a look at the breakup across venues is required. Dividing the 93 venues between decile groups gives the following net profit figures for each decile group[1]:

Rank	Player losses $m	Profits per venue $		
		Existing	Proposed	Increase
1	27.5	$475,088	$1,026,185	$551,097
2	19.9	$306,212	$671,545	$365,333
3	17.6	$256,338	$566,809	$310,472
4	13.1	$162,505	$369,760	$207,255
5	10.6	$105,840	$250,764	$144,924
6	8.2	$57,367	$143,986	$86,620
7	6.7	$40,731	$103,451	$62,720
8	5.3	$15,223	$44,968	$29,745
9	4.6	$12,902	$36,720	$23,818
10	3.9	$21,767	$51,426	$29,659
Total $m	117.3	13.1	29.2	16.1

This table indicates that under existing arrangements pubs in the top decile (the top nine pubs) are each averaging $475,088 in net profits from gaming. The

[1] *Data obtained by Andrew Wilkie for player losses for each venue in 2015/15 was used to estimate losses across the decile groups for 2020/21.*

FGM proposals will lift this to an average $1,023,186 based on player losses incurred in 2020/21, an increase of $551,097. All decile groups will more than double their net profits.

Almost all venues will be able to make super profits, well in excess of their colleagues in the rest of the food and beverage industry

For this analysis groups 1 to 7 each comprise nine pubs and groups 8,9 and 10 each comprise ten pubs. Almost all pubs in decile groups 1 to 6 have 30 EGMs. Player losses per EGM gradually falls from group 1 to group 6. Beyond that the number of EGMs per venue also gradually declines, as do player losses per EGM, with one exception, that being with group 10. This latter group has the lowest number of EGMs per venue, between 10 and 15, but average player losses per EGM are greater than for groups 8 and 9.

Overall, the pie is considerably larger but the split across all pubs will be similar.

The top 30 per cent of pubs will still get 70 per cent of what will be a very much larger pie. The bottom 30 per cent of venues will see their share remain at 5 per cent. Is this appropriate?

Federal Hotels' twelve pubs, spread amongst the top 3 decile groups will secure about 26 per cent of total venue profits, before and after, $3.5 million and $7 million respectively. If anything, this is an understatement of Federal Hotels' profits because its fixed costs spread across all venues are likely to be much lower than for other pubs.

Under existing arrangements most of the pubs in groups 7 to 10 are profitable but aren't generating super profits. Under the FGM proposals all profits will rise. Groups 7 and 10 will start making super profits in part due to lower fees (EGM authority fees) which will be payable on a per EGM basis.

The fees which apply to each EGM will vary. For the first 5 EGMs a venue will pay a fee of $1,000 per EGM. From 6 to 10 EGMs the fee will be $1,300 per EGM. And so on. Above 25 EGM the fee will be $2,500 per EGM. But such are the super profits in the industry a fee of $30,000 per EGM for the higher turnover EGMs would still leave pubs earning super profits.

Why aren't returns to the hospitality industry, specifically food and beverage which supposedly complement gaming in pubs, used as a benchmark for determining an appropriate share for pubs with EGMs?

Other States have stepped rates of tax which remove some of the super profits. As player losses increase, the tax rate, also increases, just like stepped tax rates which apply to income tax for individuals. It would be an appropriate way to remove super profits given that a market tender for EGM licenses, once the government's cornerstone policy was abandoned prior to the 2018 election.

Stepped rates are included in the proposed Section 150AK covering tax rates on the high roller casino(s). They have been used before for pub EGMs. In fact, Section 150 of the current Gaming Control Act 1993 contains a twostep system of taxes but they haven't applied since 2013 (Section 150(3)). The Section also contains grouping provisions similar to payroll tax (Section 150(4)) which operated in conjunction with the two-step tax system.

Stepped tax rates with grouping provisions will restore progressivity and fairness needed in a system that has grown into an unbalanced money operation for the benefit of a few.

The FGM proposals include the repeal of Section 150. Section 150AK is proposed to allow for a flat rate of EGM tax across all pubs. As mentioned above the FGM proposals contain a hint of progressivity with slightly higher fees per EGM for venues with more EGMs. Section 148 proposes EGM fees payable per EGM be prescribed by Regulation. At least the government has provided an opportunity for fees to increase by Regulation should the community feel the need to claw back some of the super profits from the industry. This could be done, for instance, with stepped fees based on the previous year's player losses for a venue rather than by the number of EGMs licensed by that particular venue.

As an alternative to stepped tax rates, or perhaps as a complementary measure, super profits can be clawed back via EGM fees which will be set by Regulation, This will allow the community to more appropriately share returns from gaming which, after all, is one of the aims of FGM policy.

There may be as yet undisclosed economic arguments for allowing participants in a highly regulated government mandated activity to earn super profits. Sometimes specific industries are nurtured because they generate spill over benefits for the rest of the economy. The employment effects of EGMs have been consistently exaggerated. They are certainly less than other areas of the hospitality food and beverage. There are no particular skills which will flow from gaming to other sectors. There's nothing special about the capital employed to run EGM operations which will help other sectors. To date the only spill over effects identified have been the spill over costs of social harm caused by EGMs.

The government is yet to identify any spill over benefits for the rest of the economy which may justify participants in a highly regulated government mandated activity earning super profits.

Given the scarcity of government funds to meet the unmet demands for government services across all sectors, it is not clear why the government has chosen to allow EGM pubs to earn super profits of $24.6 million per annum. This is the maximum that could be removed from pubs via extra taxes and fees, still leaving them with normal hospitality industry rates of return.

The FGM Bill proposes EGM licenses for a term of 20 years. However, after 15 years a venue can obtain a renewal which will last another 20 years. In addition, each time venues change hands the new operator will get a 20 year licence. All this means is that EGM licences will become perpetual licences. Being able to earn super profits of $24.6 million each year (based on 2020/21 player losses) makes EGM licenses very valuable. Being able to sell licenses at any time as perpetual licences means the assets will have a ready market value and the capital values of venues will rise accordingly.

> An asset based on a government mandated revenue stream is extremely valuable. The longer the term of the mandated income stream the more valuable is the asset.

Capital values are based on expected future profits. The industry rule of thumb is that $1 of profits will increase capital values by $7.50.[2] This means, based on $29.2 million of profits under FGM changes, venues will have total values of $219 million attributed to EGMs.[3] The share will be roughly in the same proportions as profits. Venues in the top 3 decile groups will get 70 per cent of the increased capital value. Federal Hotels' twelve pubs will have an approximate total value of $72 million attributable to EGMs. Note, these values are only the values attributable to the gaming operations in pubs.

The alleged reason for granting 20 year licenses is to give the industry certainty. This may have been a reasonable proposition had venues been required to pay a market price for the licence, for it would be reasonable to allow them time to recoup their investment. But licences will be gifted to venues. Disposing of a licence that has been gifted would be akin to ticket scalping. The government shouldn't repeat its failure to institute a suitable market mechanism for the allocation of the licenses, by allowing licences received as gifts to be sold as perpetual assets. The only certainty a venue operator needs is to be able to pay

> The gambling industry says profits earned by venues will be reinvested back into local communities to make them stronger. Giving untied grants is a policy without merit. Providing untied handouts in perpetuity would be reckless.

[2] *A capital multiple is used to calculate a value for a given income stream depending on the desired rate of return. A return of 12.5 per cent implies a benefit multiple of 8. One is the inverse of the other. A rate of return of 20 per cent implies a benefit multiple of 5. The chosen multiple here is 7.5 which implies a targeted rate of return of 13 per cent which is an accepted benchmark in the hospitality industry.*

[3] *Federal Hotels' Greg Farrell told a parliamentary hearing in August 2017 an independently verified model estimated capital values of EGM pubs would increase by an average of $1.5 million per venue which implies about $150 million in total.*

any contracted commitments for EGMs, lease payments etc. A five year term is all that is required.

Legislators need to be aware that with more profits in a given industry the more you will see aggregators moving in to try to capture those profits. Just as large bottleshop chains such as BWS, Dan Murphy and Federal Hotels' 9/11 now dominate bottleshop operations, so too will you see aggregators moving into gaming. Gaming will become even more attractive because of the super profits from a government mandated activity and the surety of perpetual licences.

The FGM Bill pre-empts this inevitability by proposing a new Section 101D which will limit EGMs in common ownership to a maximum of 587, one quarter of the proposed Statewide mandated cap. The biggest winner will be the sellers who will reap windfall gains from licences gifted to them because they happened to be at the front of the queue when they were handed out. The other winner will be the aggregators who will muscle their way into a lucrative government protected racket. It needs to be remembered that an aggregator will not necessarily need to acquire a freehold interest in a targeted venue. Obtaining a leasehold interest over a designated area will be sufficient.

Love Your Local was a marketing slogan that helped win the 2018 State election. It's unlikely to be invoked as a guiding principle when cashed up aggregators looking for suitable milking cows come knocking on the door trying to gain access to government mandated revenue streams.

Given the huge super profits that have been generated by EGMs over the past 25 years there is scant evidence the community has received lasting benefits.

As for the players they have hardly rated a mention. The best way to give players a more appropriate share is to slow down spin speeds, reduce maximum bet limits, increase the returns to players and remove the addictive features of EGMs which prey on vulnerable players. All of these matters could easily be incorporated within other proposed FGM changes.

The proposed FGM changes can easily be enhanced by offering low impact EGMs as part of minimising harm from problem gambling, one of the aims of FGM policy. It would be a simple matter to mandate a separate regimen of tax rates and license fees to incentivise a shift to low impact EGMs.

Whilst the above analysis suggests all venues will be better off with FGM, the full effect on smaller venues is highly conditional on a few factors.

- The outlays required to satisfy all the monitoring requirements.
- The costs to perform the regulated fee functions such as installing servicing and updating EGMs
- The costs of the market based functions currently provided by Network Gaming such as signage, training selection and financing of EGMs.The smaller more remote venues will probably face higher costs.
- Higher costs to finance EGMs than would be the case for larger operators is likely. The same will apply to leasehold operators. Clubs will also find financing EGMs challenging. There was a suggestion that the new network operator might assist, but whether that will eventuate is uncertain.
- Management time to oversee all of the above.

However, the biggest unknown for all venues in the transition to a new system is who will own the equity in the EGMs at changeover date. From a legal viewpoint Network Gaming owns the EGMs, which are probably on average, half paid for via existing finance arrangements. So, will current operators own the equity in existing EGMs or will they have to pay Network Gaming to acquire the equity in each EGM which their patrons, the humble players, have already dutifully paid?

The government's fact sheet estimates it will be $8.5 million better off with FGM changes. Not only is this a trifling amount given the profits that will be remain in the industry, but the government has glossed over the extra costs needed to regulate an industry with 100 licensees compared to the current sole licence system. Having Network Gaming with the sole licence has made the task of regulators so much easier. That will change with FGM.

Tax, CSL and who pays?

Federal Hotels' Greg Farrell was correct when he told a parliamentary hearing in August 2017 that he viewed the Community Support Levy (CSL) as merely a hypothecation of tax. To think of it as a separate impost is time wasting and pointless. It's the total of the two, the tax and the CSL which is the only relevant metric. Governments choose to hypothecate amounts as levies because it bypasses the parliamentary appropriation process and allows amounts to be spent on specified purposes.

> Tax and CSL should be viewed as one as being the returns to government. How those returns are spent is a separate issue.

CSL is a cosmetic feel-good arrangement. It makes the government appears as if it's doing something to support problem gambling by allocating 50 per cent of the CSL for that purpose. Industry members (apart from Federal Hotels) also like the arrangement because not only are they seen to be doing something about problem gambling, but it's coming out of their pockets. The industry mistakenly believe they pay the CSL. NGOs concerned about the social aspects of gambling all seem to accept this notion and hence the discussion about the CSL is always conducted on industry's terms.

However, the proposition is patently false. Gambling taxes are like GST. Whilst a supplier of goods may collect and remit GST to the ATO, the burden of the GST falls squarely upon the purchasers of the goods, the consumer. With gambling, a gambling operator will collect player losses from players, remit some as GST to the ATO and remit a further amount the State government as gambling tax. Operators remit the taxes, but the burden falls squarely on players. GST and gambling taxes are identical in this regard.

> Gambling taxes are the same as GST. Whilst an EGM operator may collect and remit both taxes, the economic burden of the taxes falls squarely on players. Operators remit the taxes, but it's the players who pay them.

Yet the industry huffs and puffs about how it pays the CSL and therefore ought to have a say in how it's spent. Nonsense. That's not how it works.

At the expiration of existing EGM arrangements and the commencement of the new FGM system, venues will be gifted a licence to operate with several conditions. One of those implicit conditions is they will remit GST as required. Another condition is that they will remit gambling taxes as legislated to the State government. At no stage can operators claim the tax comes out of their pockets. They are just the intermediaries legally responsible for collecting and remitting GST and gambling taxes.

It’s more than just a semantic point as to bears the burden of gambling taxes. It’s of fundamental importance when deciding on what taxes and at what level. Industry have been allowed to bellyache about how much tax they pay when the reality is it’s the punters who pay.

> The existing arrangements are about to expire. EGMs operators have more than fully recouped investment in EGM facilities. The government is proposing to mandate future EGM rights by way of a gift. Any taxes that need to be paid reduce the value of the gift. The burden of taxes is borne by players. It is the government/community’s right, in fact responsibility, to determine what is appropriate. Current operators do not have any inalienable or residual rights to dictate the size of the gift. That would be akin to allowing a spoiled child to bully Santa.

EGMs in casinos

When releasing the draft FGM Bill, Minister Michael Ferguson told us the release of the reform package followed “an extensive body of work, with licence fees and tax rates that apply for Far North Queensland casinos (a comparable market) used as a benchmark.”

It is not clear why the government needed to go a voyage of discovery to North Queensland to find a benchmark. There is no sound public policy basis why casinos in regional areas currently need assistance and why this benchmark was adopted. We don’t need to attract more capital for new casinos packed with EGMs as they’re prohibited. Tourists don’t come to Tassie to play EGMs. The latest SEIS report estimates tourists possibly only contribute 1.5 per cent to total gambling losses in Tasmania. Even if they came to Tasmania to play the pokies, the tax rate is irrelevant. Players play regardless of the tax rate. It’s locals who play casino EGMs so why should casino EGM be taxed (tax plus CSL) at a rate 22 cents in the $ less than EGMs in the community. Based on 2020/21 player losses in casinos of $74.66 million, Federal Hotels’ concession for its casino EGMs, compared to EGMs in the community, is $16.4 million.

There is no economic basis for giving Federal Hotels a tax concession of S16.4 million for EGMs which happen to be located in casinos. It's locals who incur almost all losses. Any concession simply gives Federal Hotels an unfair advantage over other providers in the increasingly competitive accommodation market in Hobart and Launceston.

Even if the $16.4 million of tax concessions were removed and casino EGMs paid the same rate of taxes as pub EGMs, there would still be super profits remaining, possibly as much as $15 million assuming casino EGMs are as profitable as pub EGMs.

Keno in pubs, clubs and casinos

It is reasonable to assume Keno in pubs and clubs is considerably cheaper to operate than EGMs. By its very nature it's run by a sole operator specifically Network Gaming. Keno is for all intents and purposes a lottery. Keno like lotteries such as Tattslotto, Powerball etc are games owned by the listed gambling behemoth Tabcorp. TasKeno is believed to be licensed by Tabcorp to Network Gaming.

In South Australia a statutory body called the Lotteries Commission of South Australia run Tattslotto, Keno and other games licensed by Tabcorp. Gambling taxes and profits are paid to the owner, the SA government. Keno taxes of 46 per cent are hypothecated into a Hospitals Fund.

It is not clear why the FGM proposes to raise EGM taxes to 20.31 per cent.

Why is the tax rate for Keno in pubs and clubs lower than for EGMs in pubs when the net profit percentage must be considerably higher? Did the government's discovery trip to North Queensland to investigate gambling rates involve any side trips to other states, South Australia for instance, to check stepped tax rates or search for a benchmark rate of tax for Keno?

Based on 2018/19 player losses for Keno in pubs of $33 million a tax concession for pub Keno compared to pub EGMs of 18.5 per cent amounts to

$6 million. It wouldn't be difficult to identity a hundred worthy causes for that amount of money.

However it's the proposed lowering of tax on Keno losses in casinos that leaves most observers searching for words. A proposed tax rate of 0.91 per cent is 38 percentage points lower than for EGMs in pubs. Admittedly the forgone amount is only small beer as Keno in casinos is not a big earner. The amount forgone may not be much more than $1 million. Regardless, shouldn't any tax be soundly based? Is this another benchmark discovered in the Far North? Keno is little different from a lottery, yet lotteries are taxed in Tasmania at around 80 per cent.

> The unjustifiably low rate of tax proposed for Keno in casinos highlights the dog's breakfast nature of the entire suite of proposed FGM changes. It is impossible to discern consistently applied principles which should underpin all public policy decisions, let alone one with such far reaching and long-lasting effects as FGM policy.

(*Disclosure: The writer is a non-executive director of a tourism business with EGMs)*