# Tax Reform

## Background

The American Gaming Association (AGA) is the national trade association for the commercial casino industry. In addition to representing the interests of its members on federal legislative and regulatory issues, the AGA serves as a clearinghouse for information, develops educational and advocacy programs, and provides leadership on industry-related issues of public concern. AGA's casino members own or operate more than 150 gaming properties throughout the United States, employing hundreds of thousands of workers nationally, and accounting for approximately two-thirds of the country's commercial gaming revenue.

The U.S. commercial casino industry creates hundreds of thousands of direct well-paying jobs in almost two dozen States across the country. The industry is also highly capital-intensive, building hotel casinos costing on the order of hundreds of millions to billions of dollars and a variety of other gaming facilities, filled with expensive, high-technology equipment, in order to create these jobs. To raise the huge amounts of capital necessary to make these investments, the industry relies heavily on debt financing.

- The U.S. commercial casino industry employs more than 330,000 people, who earned a total of $13.2 billion in wages, benefits, and tips in 2012. Average salary and benefits totaled almost $42,000 annually in 2010.

- In 2012, U.S. gross gaming revenue reached its second-highest level in history at $37.34 billion. Of that total, casino companies returned a record $8.6 billion in direct gaming tax contributions to states and local communities.

- When indirect and induced impacts are taken into account, the commercial casino industry supports $76 billion in spending with suppliers from a broad range of industries and other businesses, helping to generate more than 470,000 additional jobs with salaries and benefits totaling almost $25 billion in 2010.

- Thus, the commercial casino industry supported a total of approximately $125 billion of spending and nearly 820,000 jobs in the U.S. economy in 2010 – roughly equivalent to 1 percent of the $14.5 trillion U.S. gross domestic product in 2010.

- The gaming equipment manufacturing sector contributes an additional direct 31,200 jobs, with wages totaling $2.3 billion in 2012. The sector generated a total of 53,900 direct and indirect jobs in 2012. Gaming equipment manufacturing produced $13.0 billion of direct revenue in 2012, and combined direct and indirect revenue of $25.2 billion.

- The commercial casino industry is highly capital-intensive. The cost of constructing a new casino can range from $300 million to several billion dollars, depending on the size of the facility. For example, the new Revel Casino in Atlantic City cost some $2.4 billion. Ongoing capital spending by ten major gaming companies to maintain the casino facilities totals in the range of $1.2 billion annually.

- As a highly capital-intensive industry, the gaming industry relies heavily on debt financing to create these hundreds of thousands of U.S. jobs. Total outstanding debt of ten major

gaming companies is in the range of some $47 billion. Interest on that debt is in the range of $3.7 billion annually. (Deutsche Bank Global Markets Research, 2012 Gaming Almanac).

**Potential Benefits of Tax Reform for U.S. Commercial Casino Industry**

- The U.S. commercial casino industry has a relatively high effective Federal tax rate in comparison to some other industries because the casino business is essentially a cash-in/cash-out business that does not rely on industry-specific tax preferences. (The casino industry also has a very high combined Federal-State tax rate because States often impose substantial tax on gross revenues, taking as much as 55% right off the top of revenue.)

- The commercial casino industry supports corporate tax reform in the form of a reduction in the corporate tax rate and a corresponding broadening of the tax base and elimination of industry-specific tax preferences, while preserving the full deductibility of ordinary and necessary business expenses that are generally applicable across industries such as business interest expense necessary to raise capital to operate the business and, make the capital investments that are necessary to create jobs.

**Business Interest Expense Should Remain Fully Deductible**

The Administration and Congressional tax-writers have proposed various forms of limitations on the deductibility of business interest expense to help finance tax reform. The President's Framework for Business Tax Reform states that the Administration's reform plan will include a limit on the deductibility of interest expense, although no specific details are provided. The House Ways and Means Chairman's international tax reform discussion draft includes a proposal that would limit the deduction of the U.S. parent company's U.S. interest expense if both of the following thresholds are exceeded: (1) the U.S. parent has "excess" debt in the sense that it has a disproportionately greater debt-to-equity ratio relative to the worldwide corporate group as a whole; and (2) U.S. interest expense exceeds an as yet unspecified percentage threshold of the U.S. parent's adjusted taxable income (adding back interest, depreciation and amortization, net operating losses, and the section 199 deduction).

AGA strongly urges that business interest expense should remain fully deductible under tax reform:

- Interest is an ordinary cost of running a business, and its deductibility has been a longstanding basic precept of Federal tax law.

- We are aware of no other U.S. trading partner that has adopted a generally-applicable limit on the deductibility of business interest expense.

- The casino industry relies on significant debt financing and deploys this capital to develop new hotel casino projects and reinvest in existing hotel casinos and thereby generates hundreds of thousands of direct and indirect jobs. Much has been made by the proponents of tax reform about resulting economic growth effects. Raising the cost of capital by means of an interest deduction cap will undermine that growth objective. Moreover, when the Federal Reserve is doing all that it can to lower the cost of capital to aid a recovering economy, now is not the time to counteract those efforts by raising, through an interest deduction cap, the cost of the very capital that is being deployed to generate these hundreds of thousands of jobs in this one industry alone. An increase in the cost of capital

would reduce the economic viability of hotel casino development projects and could cause a significant number of them to never leave the drawing board.

- An interest rate cap would have a similar effect on job creation in a broad range of other capital-intensive industries, from manufacturing to energy to real estate.

- The casino industry, like other sectors of the hospitality industry, relies on discretionary consumer spending and hence is a cyclical industry strongly affected by the shifts in the overall economy. An interest deduction cap that is geared to the company's adjusted taxable income could have serious detrimental effects on the company by limiting or disallowing the interest deduction at a time when the company is only now beginning to recover from the Great Recession.

**Proposals to Limit on Itemized Deductions Should Not Apply to Deduction of Gaming Losses Which Simply Nets Gaming Losses Against Gaming Wins to Properly Compute Taxable Gaming Income**

- The longstanding itemized deduction for gaming losses is not a subsidy for gaming customers. It is a tool for properly measuring income. The deduction simply nets gaming losses against gaming wins to determine the customer's taxable income from gaming.

- Gaming customers are fully subject to tax on their net income from gaming. Gaming losses are offset against gaming wins to compute this net income. Under a provision that has been in the Internal Revenue Code for more than half a century, the customer's winning sessions are included in gross income, and an itemized deduction is provided for the losing sessions. Gaming losses are deductible only to the extent of gaming wins and hence cannot be used to offset the customer's other income. (I.R.C. § 165(d)).

- Proposals to cap itemized deductions as a percentage of income or to limit such deductions to a lower tax rate than applicable to the taxpayer should not apply to the gaming loss deduction under Code section 165(d). Otherwise, the gaming customer would be subject to the mismatch of being taxed on the full amount of his or her gross gaming wins, while only being able to take into account a limited amount of gaming losses – thereby taxing the gaming customer at a sharply higher effective tax rate well in excess of applicable statutory rate. In effect, the gaming customer would be taxed on income he or she had not received.

- To avoid this exceedingly harsh result, overall limitations of itemized deductions enacted in the past, such as that in Code section 68 (the "Pease" limit), have always excluded the gaming loss deduction (see Code section 68(c)(3)). The section 68 itemized deduction limit also provides a comparable exclusion for the same reason in the case of the deduction for investment interest expense under Code section 163(d) (§68(c)(2)). As with the gaming loss deduction, investment interest expense is deductible, but only to the extent of the taxpayer's investment income. In the absence of this exclusion from the section 68 itemized deduction limit, the investor – like the gaming customer – would face the mismatch of being taxed on the gross amount of investment income, while only being able to take into account a limited amount of the expenses of that investment. These rules under section 68 were recently reaffirmed and permanently extended by Congress as part of the American Taxpayer Relief Act of 2012 (Public Law 112-240).

- For all of these reasons, proposals to cap itemized deductions as a percentage of income or to limit such deductions to a lower tax rate than applicable to the taxpayer should not apply to the gaming loss deduction under Code section 165(d).