

Compact Conflicts Over FREE PLAY CREDITS

The Fight to Protect Tribal Gaming Revenue From Impermissible State Taxation

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Under the federal Indian Gaming Regulatory Act (IGRA), free play credits offered by tribal casinos are supposed to be beyond the reach of State governments. This should be beyond question. Yet recently, the State of Oklahoma, like many states, has taken on the free play issue. So why are more and more state governments devoting their time and energy to going after free play credits offered by tribal casinos? Dollar signs. The compact “revenue share” fees being demanded by some states with respect to free play credits could total in the tens of millions of dollars – severely diminishing the gaming revenues available to the tribes who, under IGRA, are meant to be the “primary beneficiary” of tribal gaming. State regulators are gambling that some tribes will simply acquiesce and pay. There is, however, simply no legal basis for tribes to pay for revenue share fees calculated by including free play credits.

The conflict over free play credits arises when State governments attempt to include “promotional” free play credits used by tribal casino patrons as part of the revenue sharing calculations under existing tribal-state compacts. The net effect of this calculation, of course, is to increase the compact revenue share fees to be paid by tribes and effectively represents an impermissible tax on tribal gaming revenues. Tribes must be prepared to deal with these collection demands as some states do not seem to be backing off. Fortunately for tribes, federal regulatory interpretations and general accounting principles demonstrate that such “state tax” sums should not be paid when a tribe decides to promote their gaming operations using free play credits.

“Free play” (or no-cost wagering) consists mainly of credits that can be used for play on gaming machines that are downloaded from a player’s loyalty card, or inserted from a promotional ticket. Generally, free play credits cannot be “cashed out” and must be cycled or played at the respective gaming operation. Winnings on free play are paid or credited to the patron’s account as redeemable credits. Ryan Burns, *Revenue Sharing and Free Play*, Indian Gaming magazine, pp. 56-57 April 2010. In effect, offering free play credits lowers the “house hold” on the machine in hopes of generating more net winnings through increased volume of play on the respective games. *Id.* This is the essence of a promotional item, something designed to bring more customers into the casino doors with the hopes that those customers will stay longer and spend more while increasing actual sales.



Considering free play is issued by tribes not for the purpose of avoiding payments to the states but to produce higher gaming revenues, states are better off encouraging more free play credits rather than taking a position that reduces the incentive in the first place. In this respect, the financial interests of both states and tribal casinos are better served when free play is not subject to revenue sharing payments.

Under most tribal-state gaming compacts, tribes are obligated to follow generally accepted accounting principles (GAAP) in maintaining their books, records and the overall management of their internal controls. According to GAAP, free play is not to be included in the “Adjusted Gross Revenues” calculations used to determine the revenue share fee payments to be made to states. In 2010, the American Institute of CPAs issued an updated *Gaming Audit and Accounting Guide* and gave guidance that free play should essentially be “washed out” of the “Adjusted Gross Revenues” calculation. That is, if free play credits are included as “receipts” in the gross revenue derived from the “handle” or coin-in of a machine, it should be subtracted out as a “payout” too. In other words, states cannot arbitrarily choose to include free play credits on one side of the gross revenue calculation and not on the other side.

Not only do most tribal-state compacts require a gross revenue calculation be done consistent with GAAP, but so do National Indian Gaming Commission (“NIGC”) regulations (*see 25 CFR Part 542.19(b)*) (“each gaming operation shall prepare



general accounting records according to General Accepted Accounting Principles”), as well as NIGC approved gaming ordinances. Likewise, the NIGC also excludes free play credits in making its revenues calculations for fee assessments and other purposes. Therefore, consistent with GAAP and NIGC regulations, free play is not to be included in calculating the “Adjusted Gross Revenues” for purposes like determining revenue sharing fees.

This is also consistent with industry practice as evidenced by numerous compacts in states like Massachusetts (*see* March 19, 2013 Mashpee Wampanoag Tribe Commonwealth of Massachusetts Tribal-State Compact at Part 3.28) (“Gross Gaming Revenues shall not include sums generated by a Patron’s wagering of any promotional gaming credit issued by the Gaming Operation.”) and Florida (*see* the 2010 Gaming Compact Between the Seminole Tribe of Florida and the State of Florida at Part III Definitions) (“Net Win” means the total receipts from the play of all Covered Games less all prize payouts and free play or promotional items issued by the Tribe”). See also the Nevada Gaming Control Board’s treatment of the issue (*i.e.*, excluding free play from the computation of “taxable” net win).

The definitive word on this issue, however, was recently provided by the Department the Interior (DOI), the federal agency charged under IGRA with the responsibility for approving tribal-state compacts and ensuring they are consistent with the requirements laid out in IGRA by Congress. In no uncertain terms, the DOI declared that including free play credits in calculating revenue sharing fees constitutes an impermissible tax on tribal gaming revenues in violation of the IGRA. In a letter concerning the “2015 compacts” between the State of New Mexico and five tribes, the Assistant Secretary-Indian Affairs commended the parties on successfully resolving the free play and point play issue, noting:

Free play and point play will now be treated according to industry standards and Generally Accepted Accounting Principles (GAAP) by excluding both from the definition of “net win,” which forms the basis for revenue sharing calculations. [. . .] Moreover, in light of its conflict with industry standards and GAAP, it is our view that ***the State’s unilateral determination to include such sums in revenue sharing calculations would be an impermissible tax on tribal gaming revenues in violation of IGRA.***

ASIA Kevin Washburn Letter to Pueblo of Jemez at page 3 (June 9, 2015) (emphasis added).

Considering the foregoing, tribes are not obligated under tribal-state compacts and IGRA to pay any additional fees claimed by states because of alleged underpaid fees associated with free play credits. Tribes should resist any efforts by states to collect additional fees associated with free play credits. Although litigation or arbitration can be costly, the fees being demanded from states for free play credits could easily run into the millions of dollars which could drain away funds the tribes could otherwise use to meet the needs of their tribal communities. The fight is worth it, especially given the fact that the law is on the tribes’ side.

As states continue to press this issue, tribes should develop a coordinated and unified front in declining to make any compact revenue sharing fee payments associated with free play credits. Presenting a unified front against the impermissible tax of “free play” credits strengthens the tribes’ collective leverage. Tribal gaming associations should facilitate tribal alliances and position statements on this important issue. If even one tribe acquiesces despite the clear illegality of the state’s assessment on free play credits, states will become emboldened to try to pick other tribes off. Tribes are in a strong position to resist these additional fee demands and should seek legal advice before conceding to these impermissible taxes. ❁



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