



The Impact of GST at 15% on the Class 4 Gambling Sector

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TAX

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1 Executive summary

This report has been commissioned by New Zealand Community Trust (“NZCT”), Southern Trust and The Lion Foundation representing 37% of the industry to assess the impact of a potential increase in GST from 12.5% to 15% on the Class 4 gambling sector (i.e. gaming machines outside casinos) and its beneficiaries.

In his opening statement to Parliament in February 2010, the Prime Minister, John Key, noted that the Government would not increase GST unless it saw the “vast bulk” of New Zealanders better off. Therefore, any increase in GST would be accompanied by personal tax reductions, as well as upfront increases in benefits, New Zealand superannuation entitlements and Working for Families packages.

Class 4 gambling proceeds are distributed to community organisations (the “beneficiaries”). Each year the Class 4 sector provides millions of dollars (estimated by Department of Internal Affairs at \$330 million) in grants to thousands of applicants. Grants are provided to a diverse range of community organisations, including New Zealand sporting groups, rescue and life saving services, education, health, arts, cultural and community groups.

Any increase in GST will have a direct impact on the amount of profit available to distribute to such beneficiaries. Modelling performed in this report estimates that, based on 2008 gambling statistics, this reduction in funding from the Class 4 gambling sector will be approximately \$15 million per annum. As the beneficiaries are not income tax payers, they will not be compensated for this loss through reductions in income tax rates.

This report concludes that the best policy option available to the Government in order to ensure the beneficiaries of the Class 4 gambling sector are no worse off from any increase in GST is to reduce the rate of gaming machine duty payable by Class 4 gambling operators to 18.3%.

1.1 Profile of the Class 4 gambling sector

The Class 4 gambling sector is subject to regulation of its operations and how it distributes its proceeds by the Government which is administered by the Department of Internal Affairs.

The Class 4 gambling sector produces profits from gaming machines. Its profit is gambling turnover less return to players (“RTP”) – gaming machine profits (“GMP”).

From those profits it pays the following amounts to the Government:

- Goods and services tax (“GST”) (currently 1/9th of GST-inclusive GMP or 12.5% of GST-exclusive GMP);
- Gaming machine duty (20% of GST-inclusive GMP);
- Licence fees (which vary with venues and machines); and
- Problem gambling levy (1.7% of GST-inclusive GMP).

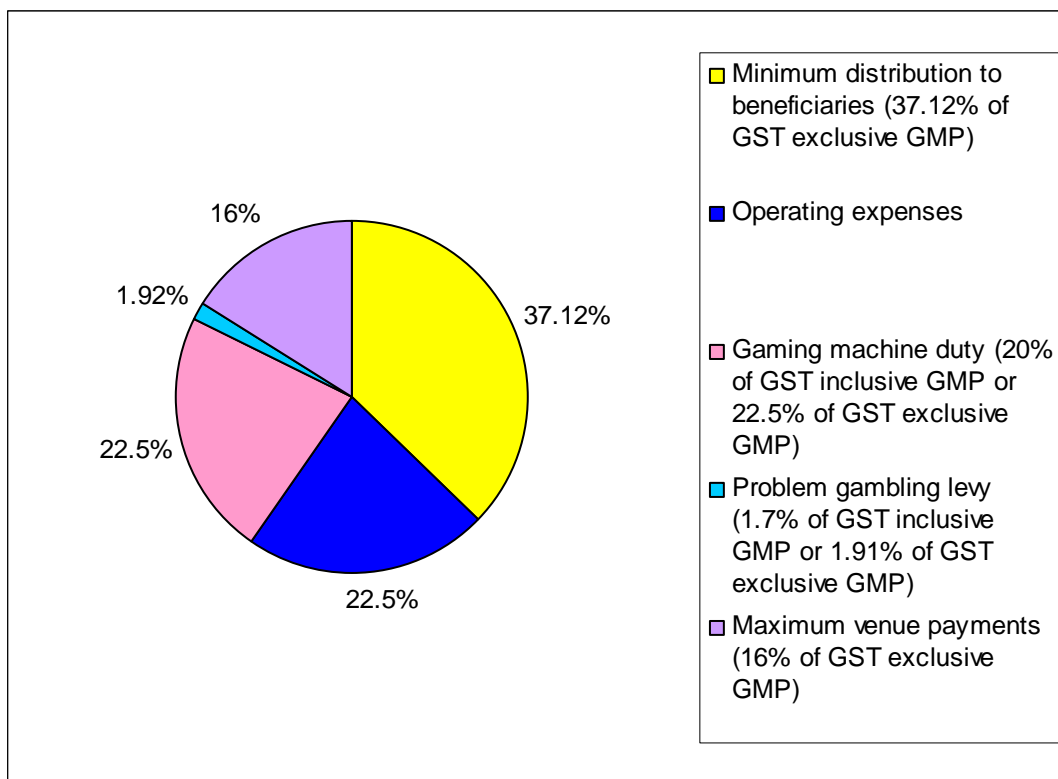
The sector incurs costs in running its operations. Its costs include

- Venue payments (limited to 16% of the GST-exclusive GMP).

The sector is required to:

- Distribute 37.12% of the GST-exclusive GMP to community organisations (“beneficiaries”) such as sporting groups, rescue and life saving services, education, health, arts, cultural and community groups.

Allocation of gaming machine profit (excluding GST)



1.2 Impact of GST at 15%

This report uses 2008 financial year data (as the most recent publicly available information on the sector) to assess the impact of an increase in GST to 15%. The modelling performed assumes costs are fixed in the 15% GST environment except where the cost is determined based on an amount which will change for the GST increase.

Extrapolating from the 2008 financial year data, we have estimated that the distributions to the community will reduce by \$15 million per annum. (The other affected costs are venue payments which reduce by \$3 million).

As the community organisations and the Class 4 gambling sector will not benefit from income tax changes (as they are not income tax payers), the GST increase will affect them without compensation.

On the basis that the change should be revenue neutral to the Government, the simplest approach is to reduce the gaming machine duty payable to the Government. We have calculated that the duty rate should decrease from its current 20% to 18.3% of the GST-inclusive GMP.

This reduction should mean that the Government continues to receive the same level of revenue from the sector while not affecting distributions to the community.

2 Potential increase in GST

In his opening statement to Parliament in February 2010, the Prime Minister, John Key, confirmed that, in order to raise revenue, the New Zealand Government (“the Government”) is carefully considering a modest increase in the rate of GST to no more than 15%. The Prime Minister noted, however, that the Government had not yet made a decision in relation to this.

The Prime Minister indicated that, if an increase in GST were to occur, it would need to be accompanied by personal tax reductions, as well as upfront increases in benefits, such as New Zealand superannuation entitlements and Working for Families packages. In addition, the Prime Minister noted that the Government would not embark on such a policy of increasing GST unless it saw the “vast bulk” of New Zealanders better off.

GST at 15% appears consistent with the Government’s intent to change behaviour from consumption to savings and investment.

This report considers the impact of an increase in GST from 12.5% to 15% on the beneficiaries of the Class 4 gambling sector grants.

3 Impact on the Class 4 gambling sector and its beneficiaries

We have modelled the impact of a GST increase on the sector through a simple example (“Figure 1”) that models \$1,000,000 of expenditure on Class 4 gambling (“bets”) and uses both regulatory requirements and sector data to derive relevant costs and distribution amounts.

Appendix 1 outlines the key factors in the regulation of the sector.

Figure 1 shows that, all other things equal, an increase in GST from 12.5% to 15% would have a direct (and negative) impact on both the net profit available for the Class 4 gambling sector to distribute to the community and the maximum amount of venue payments that can be made to venue operators (i.e. the pubs and bars that host the Class 4 gambling machines).

3.1 GST – 12.5% compared to 15%?

Figure 1

	GST at 12.5%	GST at 15%	Difference
Revenue			
Bets	1,000,000	1,000,000	0
Less: RTP (at 90.7%)	907,000	907,000	0
Gaming machine profit ("GMP") incl GST	93,000	93,000	0
Less:			
Costs paid to Government			
GST*	(10,333)	(12,130)	1,797
Gaming machine duty (20% GMP incl GST)	(18,600)	(18,600)	0
Licence fees (fixed cost)	(5,000)	(5,000)	0
Problem gambling levy (1.7% GMP incl GST)	(1,581)	(1,581)	0
Operating costs			
Venue payments (16% GMP excl GST)	(13,227)	(12,939)	(288)
Overheads, depreciation and salaries (fixed costs)	(12,019)	(12,019)	0
Net profit to distribute to community**	32,240	30,730	(1,510)
* Gaming machine profit excluding GST	82,667	80,870	(1,797)
** Percentage of GMP (excl GST) available to distribute to community	39.00%	38.00%	-1.00%

The example is based on \$1,000,000 of gambling expenditure (“bets”).

Regulation requires 87% to 92% of the bets to be RTP. 2008 gambling statistics published by the Department of Internal Affairs indicate that the RTP percentage was 90.7%. This percentage has been applied as representative of the sector’s prize distributions.

The problem gambling levy and gaming machine duty are functions of the GST-inclusive GMP and, therefore, remain constant in the 12.5% and 15% GST scenarios. In addition, licence fees, overheads, depreciation and salaries are assumed to be fixed costs and, therefore, also remain constant.

This means that the only variables between the 12.5% and 15% GST scenarios are:

- Venue payments which decrease as they are capped at 16% of the GST-exclusive GMP which reduces as a result of the GST increase; and
- Distributions to beneficiaries which decrease from 39% to 38% of GST-exclusive GMP. The 39% distribution rate has been based on the lowest of the three major trusts' (NZCT, Lion Foundation and Southern Trust) distribution ratios. It exceeds the required level of distributions.

3.2 Commentary on example's effect of the GST increase

Figure 1 illustrates the following impact of an increase in GST from 12.5% to 15%:

- The net result of an increase in GST from 12.5% to 15% is that the funds available for distribution to beneficiaries decreases from 39% to 38% of GST-exclusive GMP (both above the required percentage for distributions) or \$32,240 to \$30,730. This means that beneficiaries will not receive the same level of funding from the Class 4 gambling sector if the Government were to increase GST.
- Class 4 gambling operators will find it harder to distribute 37.12% of the GST-exclusive GMP to beneficiaries, as required if GST is increased to 15%. This is because an increase in GST would reduce the amount of GST-exclusive GMP and, therefore, result in fewer proceeds available to distribute to beneficiaries.
- Gaming venues will not receive the same level of compensation for costs from the Class 4 gambling sector if GST is increased.

3.3 Extrapolating this result across the sector

Department of Internal Affairs statistics show the total GST-inclusive GMP for the 2008 financial year was \$938 million. This means the GST-exclusive GMP would have been \$834 million. Therefore, assuming a 39% distribution rate, beneficiaries would have received \$325 million. Based on the modelling above, if GST is increased to 15%, the GST-exclusive GMP is expected to reduce by 2.17% to \$816 million so the amount distributed to beneficiaries would be \$310 million (i.e. 38% of \$816 million).

This would be a reduction of \$15m in funding for beneficiaries per annum.

4 Impact on Government revenue

An increase in the GST rate will increase GST paid by Class 4 gambling operators to their suppliers. This cost can be claimed as input tax by the Class 4 gambling sector. However, this does not reduce the Government's GST revenue from the sector.

The Class 4 gambling sector will pay the increased GST in the form of:

- Net GST paid to the Government; or
- GST paid to suppliers to the sector who would in turn pay the GST to the Government.

In other words, although some of the increased GST will not flow directly to Government from the sector (as input tax claims by the sector will increase as suppliers increase their charges for the GST increase), the Government will receive all of the GST.

As a matter of principle, the full amount of a GST increase would flow to the Government at a cost to beneficiaries and venue operators.

5 Potential solutions

5.1 Government's direct policy intention

The Prime Minister noted in his statement to Parliament that the Government's intention is that the "vast bulk" of New Zealanders should be better off from the increase in GST. This is because any increase in GST would be accompanied by reductions in personal taxes and increases in benefits.

However, as the majority of beneficiaries from the Class 4 gambling sector are charities or not-for-profit organisations, they are exempt from income tax and, therefore, will not benefit from any compensation that may be provided by the Government in the form of tax reductions.

We note that the Government has generally been supportive of charities and community organisations in the past. This is evident through regimes such as payroll giving and the donation tax credit claim. Increasing GST without providing some form of compensation to these beneficiaries appears to be counter policy.

5.2 Recommendation

In order to ensure that community organisations that are the beneficiaries of proceeds from the Class 4 gambling sector are not disadvantaged by any potential increase in GST, the Government should consider providing some form of compensation to the sector's beneficiaries.

The options are for Government to reduce one (or more) of its forms of Government revenue (GST, problem gambling levy, licence fees and/or gaming machine duty) to compensate the sector/beneficiaries. We consider each in turn.

Given a Government objective of ensuring that New Zealanders are compensated for a GST increase so that the change is largely revenue neutral for Government, there are good grounds for reducing the rate of gaming machine duty payable by the Class 4 gambling sector. We consider that this is the simplest approach from both a practical and a policy perspective.

We have calculated that to compensate the beneficiaries for the increase in GST from 12.5% to 15%, gaming machine duty would have to be reduced by 1.62% (i.e. to approximately 18.3%). This is illustrated by Figure 2.

Figure 2

	GST at 12.5%	GST at 15%	Difference
Revenue			
Bets	1,000,000	1,000,000	0
Less: RTP (at 90.7%)	907,000	907,000	0
Gaming machine profit ("GMP") incl GST	93,000	93,000	0
Less:			
Costs paid to Government			
GST*	(10,333)	(12,130)	1,797
Gaming machine duty (20% GMP incl GST)**	(18,600)	(17,090)	(1,510)
Licence fees (fixed cost)	(5,000)	(5,000)	0
Problem gambling levy (1.7% GMP incl GST)	(1,581)	(1,581)	0
Operating costs			
Venue payments (16% GMP excl GST)	(13,227)	(12,939)	(288)
Overheads, depreciation and salaries (fixed costs)	(12,019)	(12,019)	0
Net profit to distribute to community**	32,240	32,240	(0)
* Gaming machine profit excluding GST	82,667	80,870	(1,797)
** Percentage of GMP (excl GST) available to distribute to community	39.00%	39.87%	0.87%
*** Percentage of GMP (incl GST)	20.00%	18.38%	-1.62%

This example takes the modelling from Figure 1 and shows that, in order to distribute the same dollar amount of funding to beneficiaries both before and after the GST increase (i.e. \$32,240), gaming machine duty would have to be set at \$17,090. We note that this is 18.38% of GST-inclusive GMP. Accordingly, an option to compensate beneficiaries would be to reduce the gaming duty payable to the Government to 18.3% (i.e. 18.38% rounded to 18.3%).

This still leaves the Government with a positive revenue increase from the sector as result of the increase in GST. To fully equalise the Government position the duty rate would need to be reduced to 18.1% (i.e. 18.07% rounded to 18.1%). This is illustrated by Figure 3 below.

Figure 3

	GST at 12.5%	GST at 15%	Difference
Revenue			
Bets	1,000,000	1,000,000	0
Less: RTP (at 90.7%)	907,000	907,000	0
Gaming machine profit ("GMP") incl GST	93,000	93,000	0
Less:			
Costs paid to Government			
GST*	(10,333)	(12,130)	1,797
Gaming machine duty (20% GMP incl GST)**	(18,600)	(16,803)	(1,797)
Licence fees (fixed cost)	(5,000)	(5,000)	0
Problem gambling levy (1.7% GMP incl GST)	(1,581)	(1,581)	0
Operating costs			
Venue payments****	(13,227)	(13,227)	0
Overheads, depreciation and salaries (fixed costs)	(12,019)	(12,019)	0
Net profit to distribute to community**	32,240	32,240	0
* Gaming machine profit excluding GST	82,667	80,870	(1,797)
** Percentage of GMP (excl GST) available to distribute to community	39.00%	39.87%	+0.87%
*** Percentage of GMP (incl GST)	20.00%	18.07%	-1.93%
**** Percentage of GMP (excl GST)	16.00%	16.36%	-0.36%

The above example shows that the Government is revenue neutral if gaming machine duty is reduced to 18.07% (i.e. the "costs paid to the Government" is the same at both 12.5% GST and 15% GST). A gaming machine duty of 18.07% would ensure that the Class 4 gambling operators are able to pay the same dollar amount to venue operators (i.e. "venue payments") as they could at a GST rate of 12.5% (i.e. \$13,227 at both 12.5% GST and 15% GST). To ensure that this can occur, the Government would need to also increase the maximum percentage of GST-exclusive GMP to 16.4% (i.e. 16.36% rounded to 16.4%).

Accordingly, the Government has the following options:

- Reduce the gaming duty rate to 18.3% if it wishes to compensate only beneficiaries (this leaves the Government with a positive revenue increase from the sector); or
- Reduce the gaming duty rate to 18.1% if it wishes to be fully revenue neutral from the sector and increase the venue payment limit to 16.4% if it wishes to compensate venue operators.

5.3 Other options considered

We outline below alternative options available to the Government that we have considered and dismissed in order to compensate the sector and its beneficiaries.

5.3.1 GST exemption

The first option would be to introduce a special, reduced rate of GST for the Class 4 gambling sector. The Minister of Revenue has recently explicitly ruled out this option in a generic sense.

We do not favour this option as an exemption regime would affect the coherence of the GST regime. It will encourage requests for other exemptions. We can see no policy argument in favour of a GST exemption.

5.3.2 Reduce problem gambling levy

The second option would be to reduce the problem gambling levy payable by Class 4 gambling operators. As this levy is currently 1.7%, it would have to be reduced to 0% to effectively compensate the beneficiaries.

The purpose of the problem gambling levy is to recover the cost of the Government developing, managing and delivering an integrated problem gambling strategy.

Given the policy objective and acceptance of it by the sector, this option is not feasible or favoured.

5.3.3 Reduce licence fees

Class 4 gambling operators are required to hold both a Class 4 operator licence and a Class 4 venue licence for each venue that hosts its machines at all times. Licence fees are payable to the Department of Internal Affairs on application for, and renewal of, each of these licences. The third option would be to reduce the licence fees payable to the Government.

However, as these are effectively “user pays” service fees which meet the costs of the Government regulating the sector, as opposed to “revenue” to the Government, we can see no policy argument for reducing these as a result of the GST increase.

5.4 Government’s wider objective

The Government’s policy intent behind the potential increase in GST is to encourage a change of behaviour from consumption to savings and investment.

We understand the sector considers it is highly unlikely that a GST rate increase would result in increased turnover. It is more likely that the reverse would occur.

However, assessing the exact impact on behaviour of a GST increase in the sector will require additional modelling and analysis. Accordingly, we have not made any recommendations. However, at a high level, we make the following comments.

It is not possible to give a direct pricing signal to gamblers as a \$1 bet will remain a \$1 bet after the GST increase.

At best, therefore, pricing signals to gamblers would be indirect through a reduction in RTP. However, it is unclear whether a reduction in the RTP would have any impact on the demand for gambling overall. This is because, although gamblers do move from machine to machine if they consider the pay out percentage to be too low, it is unclear whether, if this occurred across all machines, the demand for gambling would be affected.

To the extent that a reduction in the RTP does affect the demand for gambling (and the GST increase could be compensated through lowering the required distribution percentage) the impact on beneficiaries may be aggravated by further reducing the amount for distribution.

Appendix 1: Regulation of the Class 4 gambling sector

Class 4 gambling operators (such as NZCT, Southern Trust and The Lion Foundation) are regulated by the Department of Internal Affairs.

In order to conduct Class 4 gambling, an organisation is required to hold the following types of licences:

- A Class 4 operator licence;
- A Class 4 venue licence for each venue that hosts its machines.

These licences are issued by the Department of Internal Affairs. Licence fees are payable by gambling operators to the Department of Internal Affairs on application for, and renewal of, each of these licences. These licence fees are essentially a “user pays” service fee.

Class 4 gambling operators must return 87% to 92% of any gambling proceeds as RTP. The remaining amount (i.e. gambling proceeds less RTP) is referred to as “gaming machine profit – net revenue” (“GMP”).

From the gaming machine profit, Class 4 gambling operators must pay the following to the Crown and Government:

- GST, which is currently charged at a rate of 12.5% on the GST-exclusive GMP or 1/9th of the GST inclusive GMP;
- A problem gambling levy, which is charged at a rate of 1.7% (plus GST) of GST-inclusive GMP; and
- A gaming machine duty, which is charged at a rate of 20% of GST-inclusive GMP.

An operator will incur:

- Venue payments paid to venue operators (i.e. the bars and clubs that host the Class 4 gaming machines). These payments cannot exceed 16% of GST-exclusive GMP; and
- Other operating expenses (including salary and wages, overheads, etc.)

Class 4 gambling operators are required to distribute at least 37.12% of GST-exclusive GMP to the community. This provides a further limitation on the expenses that it can incur. In practice, many gambling operators provide grants to community organisations in excess of this requirement. For example, NZCT, Southern Trust and The Lion Foundation generally distribute between 39% and 39.5% of the GST-exclusive GMP.