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# U.S. lotteries and the state taxman

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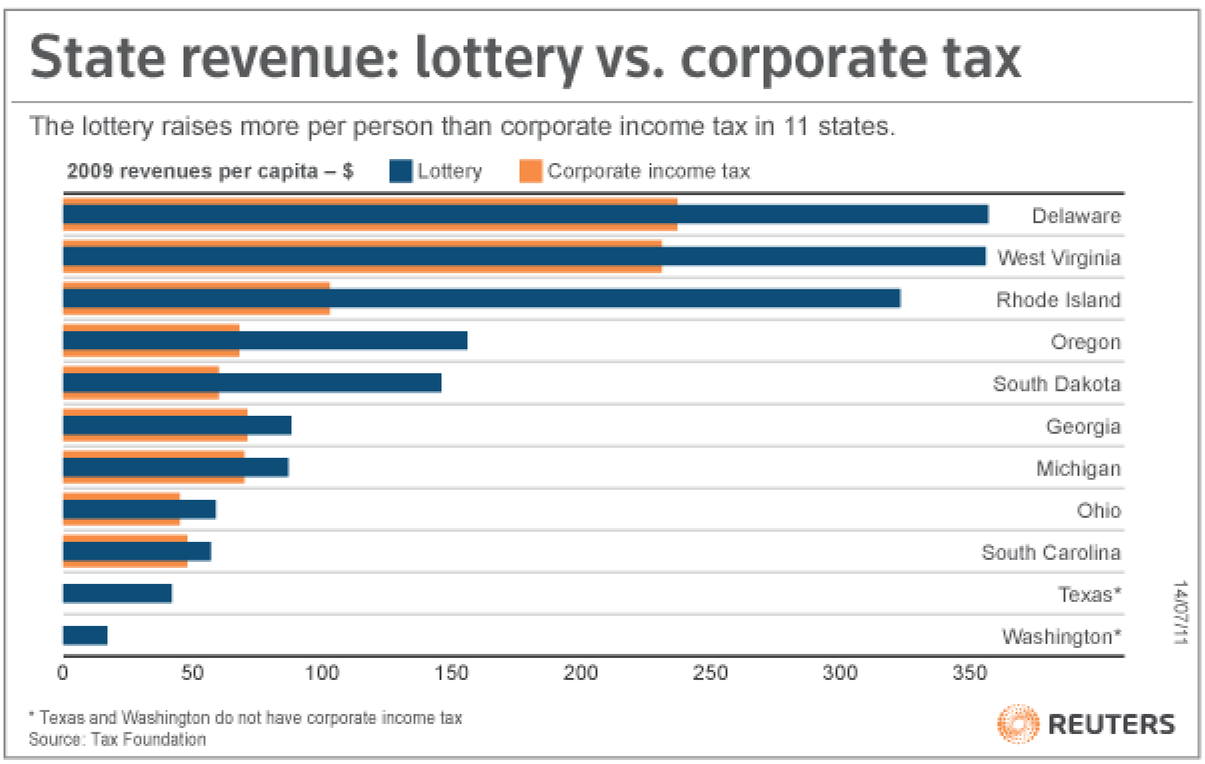
**By David Cay Johnston**
*The author is a Reuters columnist. The opinions expressed are his own.*

The long-term shift in tax burdens from capital and corporations to individuals and their activities is perhaps best illustrated by the rise of state lotteries, the most heavily taxed consumer product in America.

Because gambling is voluntary, there is little organized opposition to levies on gambling winnings. Contrast that with the ferocious, well-organized and well-financed opposition to income taxes, especially corporate income taxes.

In 11 states, lotteries provided more revenue than the state corporate income tax in 2009, Tax Foundation data show. The Rhode Island lottery netted the state more than $3 for each dollar of state corporate income tax in fiscal 2009. (See chart.)




Reuters graphic/Stephen Culp

State income taxes typically equal five percentage points or so of income recognized in a state, whether paid to individuals or corporations. Overall, lotteries pay out only about 62 percent of their revenue as winnings, an implicit 38 percent tax rate on lottery tickets. On top of that, people who win $600 or more have their take reported to federal and state tax authorities and must pay income taxes of up to 45 percent on their windfalls.

This shift from corporate to lottery revenues was unimaginable just half a century ago, when gambling was a crime everywhere except Nevada — the residue of scandals in the 1890s that killed off widespread legal gambling.

HIGH TAX RATES

These days the 44 states with lotteries (plus the District of Columbia and Puerto Rico) get 44 cents from this form of gambling for each dollar of state corporate income tax. On top of this are taxes in those states that license temples of chance.

Even more remarkable is the continuing popularity of state lotteries despite significantly high tax rates, noted Charles T. Clotfelter, a Duke University professor of law and economics who co-authored pioneering studies of lottery winners two decades ago.

Americans spent $50.4 billion on lottery tickets, video lottery terminals and the like in fiscal 2009, according to the North American Association of State and Provincial Lotteries. The 44 states with lotteries, plus the District of Columbia and Puerto Rico, pocketed $17.6 billion of lottery profits. In fiscal 2010 profits rose slightly to $17.9 billion.

On top of the 30 percent profit margin, administrative and promotional costs total about 8 percent of sales, according to David Gale, executive director of the lotteries association. That is an implicit tax of 38 percent, with 62 percent of lottery sales going to winners.

On top of that, people winning $600 or more had their income reported to state and federal tax authorities. Federal and state income taxes combined could take as little as nothing to close to 45 percent of the win for those in the top federal brackets in high-tax places such as New York City or Hawaii and who either do not itemize or fall under the alternative minimum tax. The greatest number of Americans, however, would face a federal tax of 15 percent plus the state tax of about 5 percent.

POLITICAL SENSE

Fred Thompson, a Willamette University professor of public management who has served on two Oregon commissions on state revenue, sees the rise of lotteries and the relative decline of state corporate income taxes as “something of an outrage,” but one that he said makes perfect political sense.

Like many other public finance economists, Thompson sees lotteries as a tax that falls mostly on the working poor, albeit voluntarily. And Thompson is among those who see the corporate income tax as a levy mostly on corporation owners, who by definition are wealthier than most people.

So why have lotteries, seen as a vice half a century ago, become ubiquitous today? “Because there’s no resistance to them, while taxes, especially corporate taxes, are opposed,” Thompson said. Plus, it’s an easy way to raise revenue.

More state-sponsored gambling seems likely, said I. Nelson Rose, the Whittier College law professor who wrote a book describing three waves of American gambling — colonial times, the late 19th Century and our own times starting in 1963. No state that started a lottery has rescinded it since 1963.

“Gambling has become so acceptable that when the states get into trouble, and all but four or five of them are in trouble, it is the first thing they turn to for money,” Rose said.

He noted that the shutdown of the Minnesota state government in a dispute over taxes and the budget cost the state $1.5 million per day in sales, “some of which is benefiting neighboring states like Wisconsin” as people cross the state line to buy lottery tickets.

NO REVENUE SURGE

The trend toward easy reliance on expanded lotteries, however, has not meant a surge in revenues as the economy has made modest gains.

State corporate income taxes at the end of calendar 2010 were 17.2 percent higher than a year earlier, the Nelson A. Rockefeller Institute of Government in Albany, New York, estimated recently. The $17.9 billion in fiscal 2010 state lottery profits was nearly the same as a year earlier.

But as states add more games, allow more video lottery terminals in bars and restaurants and spend to encourage gambling, it is likely that revenues will rise. Dan Sarro, who handles finances for the Rhode Island lottery, noted that traditional lottery tickets provide less than 6 percent of state lottery profits, while the video lottery terminals, which work like slot machines, are available at just two locations, but produce 94 percent of the state’s gross lottery profits.

The historic progression, Rose said, is from complicated paper-form lotteries like the one New Hampshire instituted in 1963, setting off the return of lotteries, to video games to full blown casinos.

State governments have never been particularly heavy taxers of corporations.

Back in 1963, when lotteries were still illegal, so lottery revenues were zero, state corporate income taxes raised about $10.4 billion in today’s dollars. That’s almost 60 percent of the $17.9 billion or so that state lotteries bring in today.

With global competition to attract capital, and no more resistance to what had been seen half a century ago as the evils of gambling that would bring ruin on us all, expect more state-sponsored gambling in the years ahead. It is almost certain that in the future more than 11 states will rely on a voluntary tax paid by those hoping to strike it rich to bring in more revenue than taxes on corporations. (Editing by Howard Goller)