

IS A BETTOR TO BE
LUCKY OR GOOD?

THE WAGER BETWEEN
SKILL GAMING AND GRAY
MACHINE GAMBLING

A Legislative Research Office Backgrounder



DECEMBER 2023



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Introduction

Inspectors with the Nebraska Department of Revenue (NDOR) observed a significant proliferation of a certain type of mechanical amusement device in 2016. While not quite a chance-based slot machine, these devices may award cash depending on the player's level of skill at the game. Defined as 'cash devices' in 2019 by [LB538](#), nearly every county in the state now features a location where these skill-based games are operated. Frequently called gray machines around the country, because of their historically vague legal status, cash devices often appear like arcade games or modern slot machines. However, these machines are increasingly appearing inside convenience stores and bars, rather than in casinos or gambling halls. State legislatures across the country have proposed various regulatory measures to authorize - or ban - skill games, but illegal gray machine gambling remains difficult to eliminate. In testimony to the Nebraska Legislature, cash devices have been associated with new customers and revenue for small businesses, and potential taxes for the state, but in other cases the machines represent additional market competition for casinos or a concerning cause of problem gambling.



Play Now!

What are Skill Games?

Following a seizure of devices and subsequent litigation, the Nebraska Supreme Court ruled in 2011 that the machines were not awarding players by chance, and thus they were predominantly games of skill and did not constitute gambling, pursuant to Nebraska law ([Am. Amusements Co. v. Neb. Dep't of Revenue, 282 Neb. 908](#)). Today in Nebraska, cash devices are controlled by the [Mechanical Amusement Device Tax \(MADT\) Act](#), and the games are approved and regulated by the [Nebraska Lottery and Charitable Gaming Division](#) of the NDOR.

Games of skill, by definition, are those which produce an outcome predominately caused by skill – not chance. In statute, video games of skill and skill-based devices are mechanical amusement devices, but machines which dispense cash, items redeemable for cash, or gift cards are defined as “cash devices” ([§ 77-3001](#)). Excluded from the over-arching definition of amusement devices are pickle card machines ([§ 9-345.03](#)) and gaming machines defined under the Nebraska Racetrack Gaming Act, such as historical horse racing games ([§§ 9-1101 to 9-1118](#)).

Section [77-3003.01](#) of the MADT Act describes several scenarios wherein a cash device would not be considered a game of skill. For example, if success at the game is impacted by the number or ratio of prior wins to prior losses, or by a predetermined win-loss percentage, the game is considered to be chance-based. Moreover, a cash device will not be approved if there is no possibility for the player to win every game played on the device (or if there are unwinnable games or game modes on the device) or if success requires an amount of skill that no reasonable player could exercise. A reasonable player is described in statute as someone who has, “an average level of intelligence, physical and mental skills, reaction time, and dexterity.”

Various cash device games require different levels of skill in order to succeed, but to be considered skill-based the game task must entail more than simply moving or replacing a symbol ([§ 77-3003.01 \(6\)\(d\)](#)). When the NDOR (or any court) is considering whether a device is based on skill or chance, it may utilize results from analyses on the reaction time, or other factors, required to win the game.



Win Big!

Who Owns Cash Devices?

Under the MADT Act, an operator is any person who owns a mechanical amusement device or directly or indirectly controls or manages the machine ([§ 77-3002](#)). Operators must apply to the Tax Commissioner annually for a license to both initially deploy cash devices and to remain in operation. Applicants are denied a license if they have committed a felony, a misdemeanor opposed to decency and morality, various gambling crimes, or if they are not of good character and reputation in the community in which they reside. [LB317](#), passed in 1997, reduced the application fee from \$250 to \$0 dollars beginning in the year 2000.

Those who sell, lease, or deliver possession of a cash device are classified as [distributors](#). The same limitations to issuing a license to operators also apply to distributors and, likewise, no fee is required for their annual license ([§ 77-3003](#)).

Before a cash device can be put into use, the manufacturer or distributor of the machine must receive a determination from the NDOR that the game is in compliance with the MADT Act, for a \$500 fee. The device approval application must include a specimen of the proposed device and information about the device's location, software, internet connectivity, and configuration. In addition, a report must be included from an independent testing authority (preapproved by the Tax Commissioner) indicating that the device is indeed a game of skill. Distributors also provide an affidavit that no functional changes in hardware or software will be made to the approved device without further approval from NDOR ([§ 77-3003.01](#)). From January through September of 2023, the NDOR [approved](#) 18 cash device games.

Past [testimony](#) from cash device distributors and operators is consistent – the games generate much needed revenue for small businesses. During the General Affairs Committee interim study hearing for [LR98](#), a representative from the NDOR explained that because the department is unable to properly verify the revenue reports produced by machines, they currently estimate that a typical cash device generates approximately \$1,400 dollars of revenue per week (or \$5,600 dollars per month).

For comparison, slot machines generate approximately \$7,000 dollars of revenue per month in Nebraska and \$9,000 dollars per month in Iowa. The contracts signed between cash device distributors and operators are not visible to any regulatory body, but testimony has indicated that most contracts stipulate a 50-50 revenue sharing agreement between the two parties.

The scale of revenue for cash devices is similar to keno games where nearly \$350 million dollars was wagered on keno in [2022](#), resulting in \$31 million dollars in profit for keno operators. The NDOR currently estimates that \$365 million dollars are wagered annually at cash devices in Nebraska, and that 15 percent of those wagers (\$55 million dollars) amount to gross revenue generated for licensed cash device operators and distributors across the state.

Play Here!

Where are Cash Devices Located?

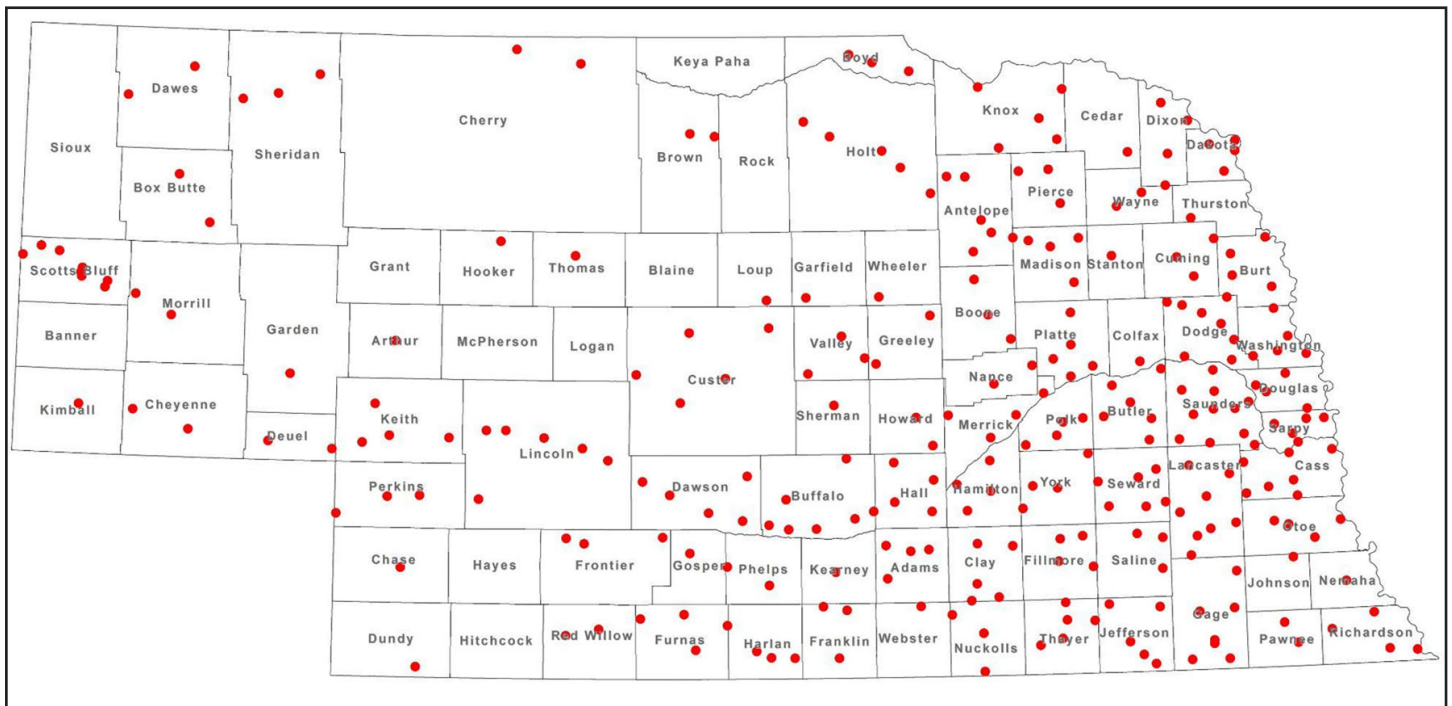
After preliminary third-party testing in 2007, approximately 430 skill games were deployed in 143 cities in Nebraska. By 2016, the NDOR began requiring licensees to differentiate the type of mechanical amusement devices that they offered in their establishments. At this point, the count of cash devices in the field in 2016 (as opposed to pool, shuffleboard, and pinball games) stood at 1,600.

The total number of cash devices in Nebraska has grown substantially over the past seven years. As of September 2023, nearly 4,700 cash devices had been installed in 286 cities and villages in Nebraska. Today, there are more establishments in the state where skill-based cash devices can be played (1,578) than locations featuring prominent games that are based on chance like the lottery (1,180), keno (538), and pickle cards (477).

Any owner or operator of a retail establishment may only place four cash devices in their business – if the facility is 4,000 square feet or less. However, for every additional 1,000 square feet, another cash device may be deployed up to a maximum of 15 cash devices ([§ 77-3001.01 \(8\)\(b\)](#)). The language in current Nebraska law has led to the formation of straw businesses, such that a small portion of a large facility is dedicated to one function (e.g., retail), while the remaining area houses numerous cash devices.

Consequently, several establishments have appeared in Nebraska that market themselves as “[skill game casinos](#).” Among cash device locations, 70 percent are under 4,000 square feet, but 43 locations in the state are 15,000 square feet or larger and feature the maximum number of allowable cash devices.

Cities and Villages in Nebraska with Cash Devices



Source: Nebraska Problem Gamblers Assistance Program

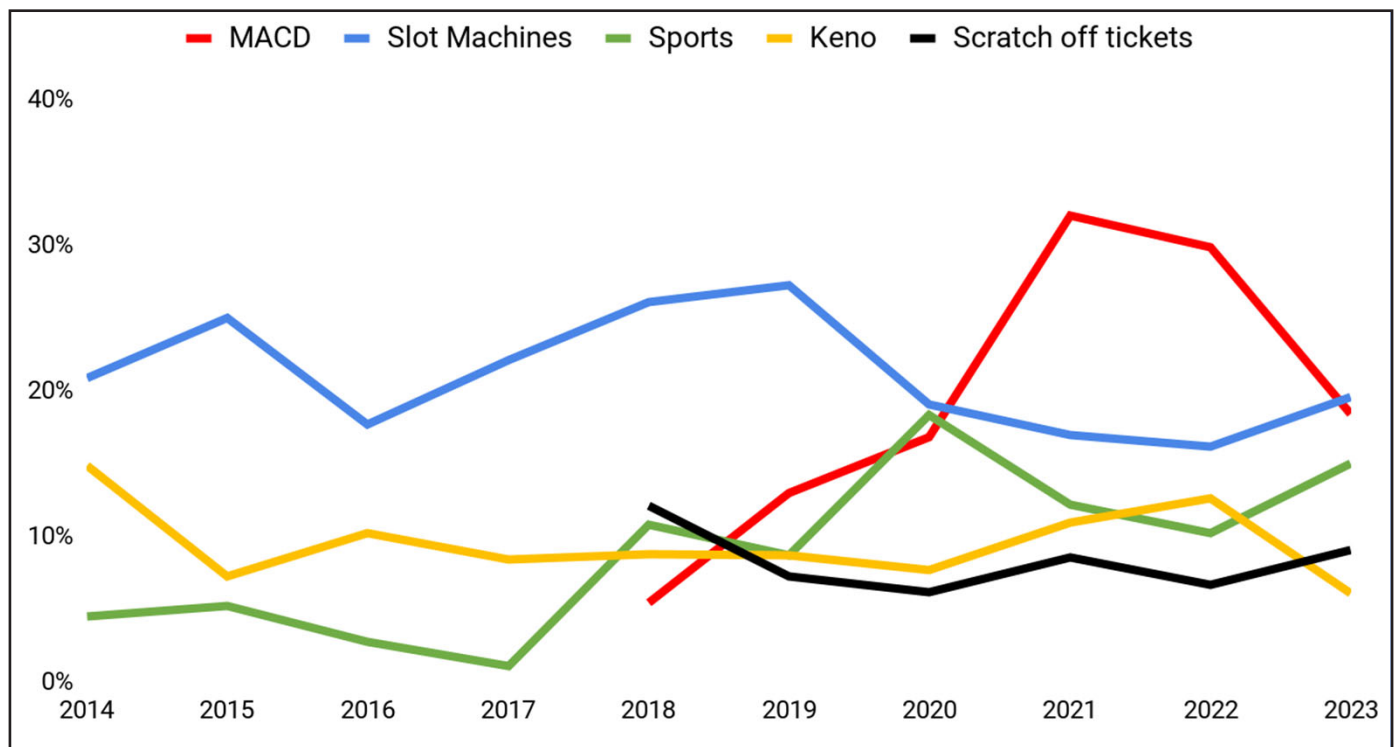
Full Tilt!

Who Plays Cash Devices?

Data from the [Nebraska Problem Gamblers Assistance Program](#) indicates that clients who played cash devices reported similar issues as those who were seeking treatment for an addiction related to slot machines or another form of chance-based gambling. Although, clients addicted to cash devices were often younger and more likely earn a lower income than other clients. Cash device players were also more likely to report that they broke the law to support their addiction (53 percent) compared to all other clients (23 percent). Generally, problem gambling clients often state that they have emotional, financial, and family relationship problems. Survey results provided in the hearing for LR98 revealed that a greater percentage of cash device players reported suffering from emotional, financial, and family issues compared to other clients.

Overall, the proportion of mechanical amusement cash device problem gambling clients has increased since 2018. The combined percentage of cash device players and slot machine players account for half of all clients seeking assistance for problem gambling in 2023. In terms of the price of care, the program-wide average direct counseling cost (\$3,440 per client) is similar to the average cost of treatment for cash device problem gamblers (\$3,591).

Proportion of Problem Gambling Program Clients by Type of Gambling



Source: Nebraska Problem Gamblers Assistance Program

You Lose!

Cash Device Regulation and Enforcement in Nebraska

Numerous regulatory issues related to cash devices in Nebraska were presented by the NDOR during the interim study hearing for LR98, including: consumer protection, tax collection, and the lack of accurate reporting and appropriate enforcement mechanisms.

Normally, players' cash prizes are awarded by operators, but the processes for payouts vary from location to location. In some cases, operators may charge players a fee for large payouts, such as a 10% fee on winnings over \$100 dollars. Inevitably, occasions arise when retailers don't have enough cash on hand to promptly award players their winnings. In these cases, the distributor must supply the payout, but no maximum time limit has been imposed for when the prize must be paid. From the prospective of protecting businesses, operators have reported instances of counterfeit prize tickets, but the NDOR currently has no authority to investigate such events.

The lack of verifiable reporting from cash device machines themselves has led to issues with appropriate tax collection. Cash devices are subject to several taxes, including a tax on the income earned by players or businesses and a sales tax on any associated leases. Preliminary audit results from the NDOR indicate that several million dollars in tax is owed from distributors on the value of leases since 2022.

Once a cash device game has been approved, a decal must be purchased and displayed on the device prior to its placement and activation. At \$250 dollars per decal, more than \$1.24 million dollars was collected in fiscal year 2022-2023 for the sale of nearly 5,000 cash device decals. For comparison, a 2 percent tax on the gross proceeds of keno netted the state over \$7.1 million dollars in the same time frame. Additionally, municipalities are allowed to levy an occupation tax upon the business of operating mechanical amusement devices. Operators must pay an annual occupation tax for each machine - \$35 or \$20 dollars depending on date of installation – and the taxes collected are remitted to the General Fund ([§ 77-3004](#)).



You Lose!

Cash Device Regulation and Enforcement in Nebraska Continued

Consequences for violations of the Mechanical Amusement Device Tax Act include an administrative penalty for improper display of a machine decal or for the lack of a license (\$75 dollars for each violation) and a Class II misdemeanor for any violation of the act itself ([§ 77-3009](#)). The MADT Act prohibits the operation of a cash device using a credit card, charge card, or debit card, and prohibits anyone under age 19 from playing a cash device ([§ 77-3003.02](#)). Concerns have been raised in testimony about the lack of formal security procedures at cash device locations and about the ease with which those under age 19 could access the games, but no associated penalty exists in statute.

The Tax Commissioner and their agents may seize, without a warrant, any mechanical amusement device if there is cause to believe it is not compliant with the MADT Act or any rules or regulations promulgated under the act (or if it bears an expired license decal). Additionally, any operator of a cash device which constitutes a game of chance is subject to a \$1,000 fine for each day of illegal operation ([§ 77-3001.01 \(1\)\(a\)](#)). However, several months may pass between when a suspected illegal cash machine is first observed and when an investigation is finalized, resulting in an enormous monetary penalty.

Possession of an unlawful gambling device is a Class II misdemeanor, but the owner of a retail establishment shall have an affirmative defense if the device bears an unexpired decal, unless they had prior knowledge that it was an illegal device ([§ 28-1107](#)).

Through nine months in 2023, the NDOR had conducted 3,120 inspections on cash devices. During 2022 and 2023, 10 enforcement activities were executed due to various violations of the MADT Act and other laws related to cash devices. In one such case, the [owners](#) of a skill game casino in North Platte were charged in February 2023 with tax evasion, and shortly afterward the same first class city saw a rash of skill game robberies ultimately ending with a woman receiving a three year prison sentence in [August](#) for the crimes.

Image Credit: Bet_Noire via iStock



Beat the Odds!

Regulation of Skill Games Across the Country

Recent skill game regulation proposals and court rulings have varied greatly across states; some have attempted to ban the devices outright, while others have decided to integrate skill games into their existing gambling laws. In the Commonwealth of Kentucky, [legislation](#) was signed in 2023 which bans skill games that are similar to the cash devices operating in Nebraska. Currently pending are two lawsuits, filed by the game makers, that are challenging the constitutionality of the bill. Recently, a judge in the Bluegrass State ordered that while the case is adjudicated court, the machines can physically stay in place, but no one may play the games.

Bills introduced in the Virginia [House](#) and [Senate](#) were signed into law in 2020 which essentially proclaimed that skill games which award cash prizes were illegal. The new law intended to ban the devices beginning in July 2021. Prior to the skill game ban taking effect, a lawsuit was filed stating that the new law violated free speech rights and thus was unconstitutional. An [injunction](#) was later issued in December 2021 that allowed skill game devices that were already registered with the state to continue operation. However, in [October](#) 2023, the Virginia Supreme Court vacated the injunction, finding that the lawsuit is unlikely to succeed, and the ban on skill games in The Old Dominion was reinstated. Still, the pivotal trial regarding skill games in the Commonwealth of Virginia will begin in December 2023 in a lower court.

The Commonwealth Court of Pennsylvania [ruled](#) in 2023 that skill games are legal and that they don't necessarily require regulation or taxation. The court found that the Keystone State's laws regulating gambling were intended to oversee casino establishments featuring thousands of slot machines and not skill game devices found in public, like in social clubs and laundromats. A state Senate committee heard [testimony](#) in August 2023 that by not regulating and taxing the skill game devices, the state forgoes an estimated \$250 million dollars in revenue.

In Georgia, skill games are regulated and taxed much like in Nebraska. The games are regulated by the [state lottery](#) and more than \$140 million dollars in tax revenue was generated from approximately 33,000 machines in 2022. Currently, Georgia law requires that revenue generated by skill games be shared between distributors (45%), operators (45%), and the state lottery (10%). Additionally, winnings that a player earns from a skill game may only include in-store credit or credit towards other lottery games. Georgia law also requires that all skill game devices be connected to a central accounting terminal via the internet in order to enhance auditing, reporting, and regulation ([§ 50-27-101](#)). A [bill](#) introduced in the Peach State in 2023 proposes several measures related to skill game regulation and enforcement. The new legislation would, among other provisions, allow winnings in the form of gift cards that can be used anywhere – a move attempting to curb illegal cash payouts.

Beat the Odds!

Regulation of Skill Games Across the Country Continued

The Illinois Gaming Board regulates, taxes, and reports on “video gaming” in the Land of Lincoln. According to the latest state [revenue reports](#), nearly 8,500 establishments in Illinois feature 46,673 skill game devices. Through September of 2023, over \$24 billion dollars had been played in skill games, and so far, players have lost more than \$2.1 billion dollars (9 percent). The resulting 2023 tax revenue collected in Illinois through nine months, at a rate of 34 percent, has climbed past \$730 million dollars. The state of Illinois collects 85 percent of the tax revenue generated while 15 percent is sent back to local municipalities.

Recently, a [skill game ban](#) was introduced in the Illinois Senate which proposed to outlaw any device that accepts an item of monetary value, allows the user to play a game that involves - or is dependent upon - an element of chance, and awards a thing of value in the end. After passing through the Senate in 2023, the bill did not advance in the Illinois House chamber.

A recent [report](#) on gambling, published by an Illinois legislative fiscal research [commission](#), conveyed that the marketplace may be reaching a saturation point with 94 percent of municipalities in the state allowing video gaming. Notably, however, the third largest city in the country, Chicago, prohibits the devices. The commission also stated that new market competition in the form of “sweepstakes” machines should be monitored. These gray machines are unregulated and not subject to taxation in Illinois, yet they operate in a similar manner to skill games.

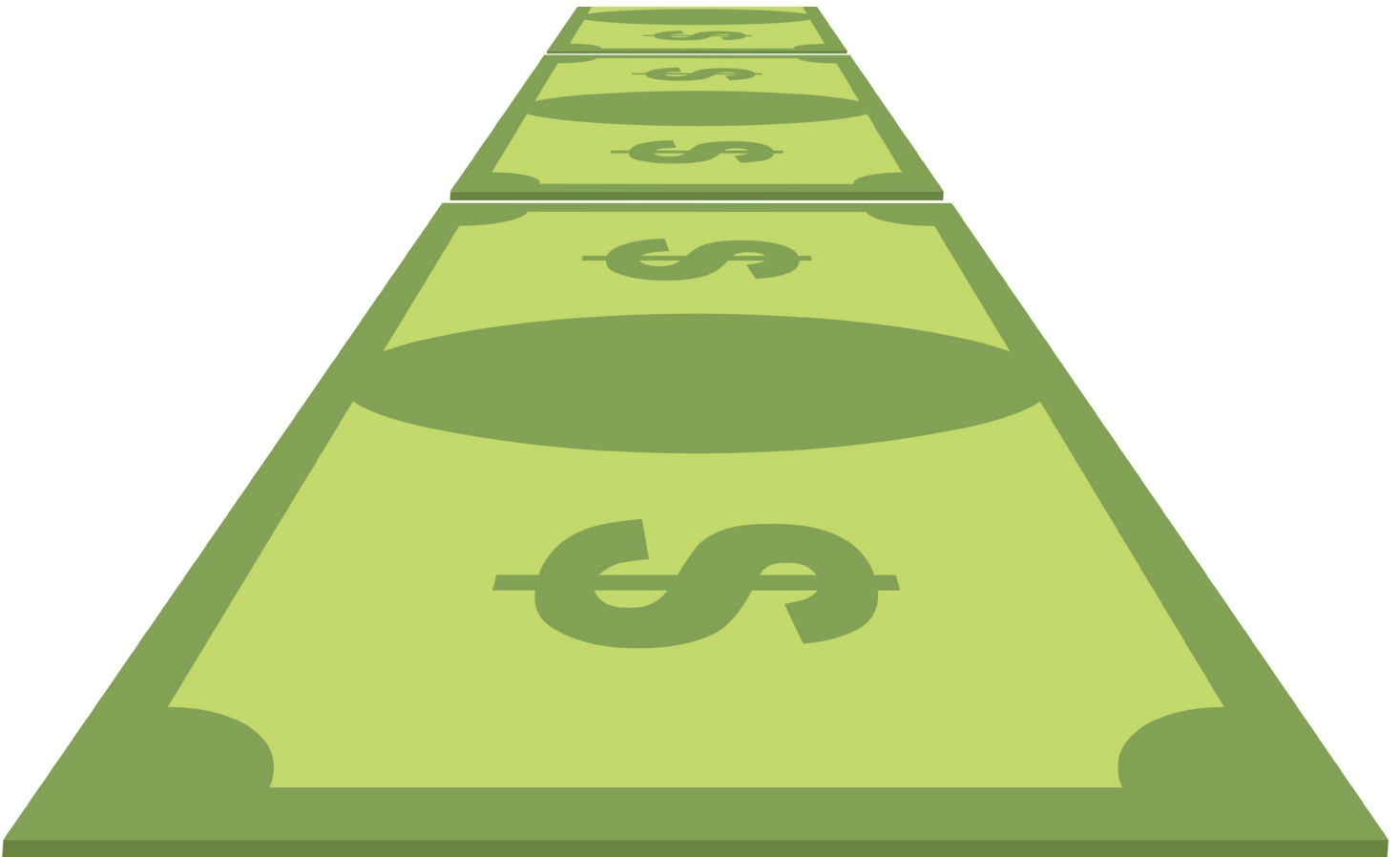
Jackpot!

Conclusion

Perceptions of cash devices from the perspectives of businesses and regulators vary greatly. However, recent [survey data](#) from the American Gaming Association revealed that most of the respondents who were familiar with skill games believed the devices to be no different from chance-based slot machines (65 percent).

During testimony for LR98, the NDOR provided the General Affairs Committee with several recommendations, from the department's perspective, to enhance regulation and enforcement of cash devices. Recommendations included additional flexibility with regard to fines and penalties, the ability to suspend and revoke licenses, and more restrictive qualifications for acquiring licenses. The department also suggested procedures to manage the overall population of devices, to gain visibility into contracts, and to improve reporting and taxation.

With more skill game machines in Nebraska per capita (412.7) than in Georgia (308.4) or Illinois (274.5), it appears cash devices are here to stay (and play!). While conducting research in the field, it was determined that the skill games themselves provided little amusement, as compared to a pinball or arcade game, but the thrill of a possible jackpot was enticing, if only for a moment.



Resources

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