IN THE SUPREME COURT
OF THE
STATE OF SOUTH DAKOTA

No. 27055

FIRST GOLD HOTEL, MINERAL PALACE HOTEL AND GAMING, and FOUR ACES GAMING, LLC,

Plaintiffs/Appellants,

vs.

SOUTH DAKOTA DEPARTMENT OF REVENUE AND REGULATION,

Defendant/Appellee.

Appeal from the Circuit Court
Sixth Judicial Circuit
Hughes County, South Dakota

The Honorable Mark Barnett, Presiding Judge

BRIEF OF APPELLANTS

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JURISDICTIONAL STATEMENT

Plaintiffs and Appellants First Gold, Inc. ("First Gold"), Mineral Palace, LP ("Mineral Palace"), and Four Aces Gaming, LLC ("Four Aces") (the Plaintiffs will be referenced collectively as the "Gaming Establishments") appeal from a March 24, 2014, Judgment and Order, which granted the summary judgment motion of Defendant and Appellee South Dakota Department of Revenue and Regulation ("Department"), denied the Gaming Establishments' summary judgment motion, and dismissed the Gaming Establishments' declaratory judgment action. CR 142 & 144.[1] Notice of Entry of the Judgment and Order was given on April 1, 2014. CR 147. The Gaming Establishments timely filed their Notice of Appeal on April 14, 2014. CR 153. Thus, this Court has jurisdiction over this matter as an appeal from a final judgment. *See* SDCL § 15-26A-3.

ISSUES

1. Whether free play may be included within adjusted gross proceeds so as to constitute taxable income to the Gaming Establishments?

The Circuit Court decided free play is included within adjusted gross proceeds.

[1] The record below is cited as "CR," followed by the page numbers assigned in the Clerk's Register of Actions. The transcript from the summary judgment hearing will be referenced by "HT," followed by the appropriate page designation. Items in the Appendix will be referred to as "App." and the applicable page number.

Matter of Sales and Use Tax Refund Request of Media One, Inc., 1997 S.D. 17, 559 N.W.2d 875.
Goetz v. State, 2001 S.D. 138, 636 N.W.2d 675.
SDCL § 42-7B-4.
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A.R.S.D. 20:18:22:12.

2. Whether the Gaming Establishments may seek declaratory judgment relief?

The Circuit Court ruled the Gaming Establishments were seeking refunds.
Dan Nelson, Automotive, Inc. v. Viken, 2005 S.D. 109, 706 N.W.2d 239.
Tracfone Wireless, Inc. v. South Dakota Dep't of Revenue and Regulation, 2010 S.D. 6, 778 N.W.2d 130.

3. Whether the outcome of this action is controlled by prior rulings from the South Dakota Commission on Gaming?

The Circuit Court agreed the Gaming Commission's prior rulings were not binding, but gave deference to the Gaming Commission, considered them instructive, and viewed this action as another "bite at the apple."
Paul Nelson Farm v. South Dakota Dep't of Revenue, 2014 S.D. 31, ___ N.W. 2d. ___, 2014 WL 2135971.

STATEMENT OF THE CASE

The Gaming Establishments appeal the dismissal of their declaratory judgment action and the Circuit Court's decision that free play is included as a part of the adjusted proceeds of gaming under SDCL, Ch. 42-7B, its implementing regulations, and applicable law.

The Gaming Establishments are each licensed gaming businesses, offering limited gaming to the public in Deadwood, South Dakota. CR 10 at ¶¶ 3 & 7 and 27 at ¶. To attract patrons to their establishments, they offer various

promotions, and among these promotions is "free play." CR 10 at ¶ 10 and 27 at ¶ 11. Free play generally offers patrons an opportunity to play slot machines at the Gaming Establishments without using the patrons' own money. CR 10 at ¶ 10; 27 at ¶ 11; 106 at ¶ 3; 96 at ¶ 3; 111 at ¶ 3. Although free play offers no income to the Gaming Establishments, the Department has taken the position that it is included within the adjusted proceeds of gaming, such that the Gaming Establishment must pay tax on free play. CR 11; *see also generally* HT.

The Gaming Establishments brought a declaratory judgment action in Circuit Court, Sixth Judicial Circuit, Hughes County, requesting the Court to declare that free play does not constitute a wager or bet and is not to be included in the Gaming Establishments' adjusted gross proceeds. CR 10. The parties filed cross motions for summary judgment. CR 81 & 99. After briefing and oral argument by the parties, the Circuit Court, the Honorable Mark Barnett presiding, issued a written memorandum decision, granting summary judgment to the Department and denying summary judgment to the Gaming Establishments. CR 142. The Gaming Establishments appeal this ruling. CR 153.

STATEMENT OF FACTS

The parties in this case generally agree as to the underlying facts. The parties' dispute concerns the interpretation of laws applicable to those facts. The Gaming Establishments are each licensed gaming businesses, offering limited gaming to the public in Deadwood, South Dakota. *See* CR 10 ¶¶ 3 & 7 and 27 at ¶ 5. In order to attract patrons, the Gaming Establishments offer various promotions. *See* 10 at ¶ 10 and 27 at ¶ 11. Among these promotions is "free play." *Id.*; *see also* CR 106 at ¶ 2; 96 at ¶ 2; 111 at ¶ 2.

Generally, free play gives patrons the opportunity to play slot machines at the Gaming Establishments without using any of the patrons' own money. *See* CR 10 at ¶ 10; 27 at ¶ 11; 106 at ¶ 3; 96 at ¶ 3; 111 at ¶ 3. At First Gold, free play credits are stored on a computer server. *See* CR 106 ¶ 4. First Gold patrons with free play credits have players' accounts, and the players may access the free play credits in their own players' accounts by using their plastic card IDs and personally unique PIN numbers. *Id.* At Mineral Palace, free play is downloaded to a gaming device through a plastic card, similar to a credit/debit card, and at the tables, it is given to the specific customer as a special type of chip that cannot be redeemed. *See* CR 96 at ¶ 4. Four Aces gives free play to its patrons in the form of a paper slot or table game coupon provided by Four Aces. *See* CR 111 at ¶ 4.

Patrons with free play cards or coupons may insert the cards or coupons into slot machines and play the slot machines without using any of the patrons' own money; rather, when free play occurs, the slot machines operate by using the credits shown on the free play cards or coupons. *See* CR 106 at ¶ 5; 96 at ¶ 5; 111 at ¶ 5. If a slot machine pays out while being operated with a free play card or coupon, the patron will win money. *See* CR 106 at ¶ 6; 96 at ¶ 6; 111 at ¶ 7.

Free play credits or coupons cannot be redeemed for cash, merchandise, or other promotional offers. *See* CR 106 at ¶ 7; 96 at ¶ 7; 111 at ¶ 8. Four Aces' patrons with free play table game coupons are not allowed to redeem their coupons for cash or chip value. *See* CR 111 at ¶ 6. Rather, Four Aces' patrons are allowed one free hand at a table game of their choice for the value of their free play table game coupon, at which time, the free play table game coupon is placed on the table, in front of the patron, and the hand is played. *Id*.

The Gaming Establishments place other limits on free play. First Gold limits how many free play credits may be downloaded at a time and per day. *See* CR 106 at ¶ 8. At Mineral Palace, free play is a limited number of credits for play on a slot machine or table. *See* CR 96 at ¶ 8. At Four Aces, free play slot or table game coupons have a limited number of credits for play. *See* CR 111 at ¶ 9. The free play credits or coupons may be used only by the patron to whom the Gaming Establishments gave them. *See* CR 106 at ¶ 8; 96 at ¶ 8; 111 at ¶ 9. Further, free play credits and coupons have expiration dates. *See* CR 106 at ¶ 9; 96 at ¶ 9; 111 at ¶ 10.

Patrons do not and cannot buy free play from any of the Gaming Establishments, and none of the Gaming Establishments sell free play. *See* CR 106 at ¶ 10; 96 at ¶ 10; 111 at ¶ 11. Rather, Gaming Establishments give free play to patrons to attract business. *See* CR 106 at ¶¶ 2 & 10; 96 at ¶ 2, 4 & 8; 111 at ¶¶ 2 & 4. Free play has no transferable value. *See* CR 106 at ¶ 11; 96 at ¶ 11; 111 at ¶ 12.

The Gaming Establishments have been including free play in the calculation of their adjusted gross income and remitting gaming tax in accordance with that calculation because the South Dakota Department of Revenue (hereinafter referenced as the "Department") has characterized free play as a wager or bet, thus including free play in the adjusted gross

income of the Gaming Establishments. *See* CR 106 at ¶ 12; 96 at ¶ 12; 111 at ¶ 13. In the present suit, the Gaming Establishments seek a declaration that free play is not to be included in the calculation of the Gaming Establishments' adjusted gross proceeds and is, accordingly, not subject to the gaming tax. *See* CR 10. Therefore, the Gaming Establishments may seek refunds of the gaming tax paid as a result of the Department's erroneous characterization of free play as a wager. *Id.*

ARGUMENT

Standard of Review and Principles of Statutory Construction

The standard of review by which this Court considers an appeal from cross summary judgment motions is well established.

> In reviewing a grant or denial of summary judgment under SDCL 15-6-56(c), [the Court] must determine whether the moving party demonstrated the absence of any genuine issue of material fact and showed entitlement to judgment on the merits as a matter of law. The evidence must be viewed most favorably to the non-moving party and reasonable doubts should be resolved against the moving party. The non-moving party, however, must present specific facts showing that a genuine, material issue for trial exists. Our task on appeal is to determine only whether a genuine issue of material fact exists and whether the law was correctly applied. If there exists any basis which supports the ruling of the trial court, affirmance of a summary judgment is proper.

Waddell v. Dewey County Bank, 471 N.W.2d 591, 593 (S.D.1991) (citing *Garrett v. BankWest, Inc.,* 459 N.W.2d 833, 836-37 (S.D.1990)).

As the facts in this case are essentially undisputed, the issues arise from application of statutes and regulations to those facts. The Court has noted there are:

> two primary rules of statutory construction. The first rule is that the language expressed in the statute is the paramount consideration. The second rule is that if the words and phrases in

> the statute have plain meaning and effect, we should simply declare their meaning and not resort to statutory construction.
>
> We explained the purpose of these primary rules of statutory construction in *US West v. PUC,* 505 N.W.2d 115, 123 (S.D.1993):
>
>> The purpose of statutory construction is to discover the true intention of the law which is to be ascertained *primarily* from the language expressed in the statute. *Appeal of AT&T Information Systems,* 405 N.W.2d 24, 27 (S.D. 1987). The intent of a statute is determined *from what the legislature said, rather than what the courts think it should have said,* and *the court must confine itself to the language used. Id.*
>>
>> Words and phrases in a statute must be given their *plain meaning and effect. Id. When the language of a statute is clear, certain and unambiguous, there is no reason for construction,* and the Court's *only function is to declare the meaning* of the statute as clearly expressed. *Id.*
>
> (emphasis added).

Goetz v. State, 2001 S.D. 138, ¶¶ 15-16, 636 N.W.2d 675, 681. The statutes to be considered are generally found in SDCL, Ch. 42-7B, "Limited Card Games and Slot Machines – Gaming Commission." The rules of statutory interpretation and construction also apply to administrative regulations. *See Hartpence v. Youth Forestry Camp*, 325 N.W.2d 292 (S.D. 1982). The regulations under consideration are generally located within A.R.S.D. 20:18.

Because the statutes impose a tax, the Court has also established rules about which party bears the burden of proving imposition. By their plain language, the statutes to be applied to the facts of this case – SDCL §§ 42-7B-28 and 42-7B-28.1 – are explicitly "imposition" tax statutes. *Please see* the text of these statutes quoted below.

> > The question of whether a statute imposes a tax under a given factual situation is a question of law. Statutes which impose taxes are to be construed liberally in favor of the taxpayer and strictly against the taxing body. Statutes exempting property from taxation should be strictly construed in favor of the taxing power. The words in such statutes should be given a reasonable, natural, and practical meaning to effectuate the purpose of the exemption.
>
> *National Food Corp. v. Aurora Cty. Bd. of Comm'rs,* 537 N.W.2d 564, 566 (S.D.1995) (citing *Thermoset Plastics, Inc. v. Department of Revenue,* 473 N.W.2d 136, 138–39 (S.D.1991)); *see also Estate of He Crow v. Jensen,* 494 N.W.2d 186, 191 (S.D.1992) ("[W]e construe administrative rules according to their intent as determined from the rule as a whole and other rules relating to the same subject.").

Matter of Sales and Use Tax Refund Request of Media One, Inc., 1997 S.D. 17, ¶ 9, 559 N.W.2d 875, 877-78 (S.D. 1997).

As the statutes to be considered in this case impose a gaming tax upon the Gaming Establishments, the statutes are to be construed liberally in favor of the Gaming Establishments and strictly against the Department, and the Department bears the burden of proving the statutes impose the tax as asserted by the Department. *National Food Corp. v. Aurora County Bd. of Comm'rs*,

537 N.W.2d 564, 566 (S.D. 1995); *Sioux Valley Hospital Association v. State*, 519 N.W.2d 334, 335 (S.D. 1994).

When the Court reviews the specifically applicable statutes and regulations, keeping in mind that they are to be construed liberally in favor of the Gaming Establishments and strictly against the Department, with the Department bearing the burden of proving imposition of the tax, the Court should conclude free play cannot be a part of adjusted gross proceeds of the Gaming Establishments so as be taxable income to them.

1. Free play cannot constitute adjusted gross proceeds to the Gaming Establishments and so cannot be taxed as income to them.

Limited gaming is permitted in South Dakota under SDCL, Ch. 42-7B, "Limited Card Games and Slot Machines – Gaming Commission." Chapter 42-7B also includes the statute imposing a state tax on the proceeds of that gaming. SDCL § 42-7B-28 reads, "[t]here is hereby imposed an eight percent gaming tax on the adjusted gross proceeds of gaming allowed by this chapter." Additionally, SDCL § 42-7B-28.1 "impose[s] an additional one percent tax on the adjusted gross proceeds of gaming allowed by this chapter."

As noted above, SDCL §§ 42-7B-28 and 42-7B-28.1, by their explicit use of the word "impose," are plainly "imposition" tax statutes. Thus, they are to be construed liberally in favor of the taxpayer, and the Department bears the burden of proving they impose the tax as asserted by the Department. *National Food Corp.*, 537 N.W.2d at 566

(S.D. 1995); *Sioux Valley Hospital Association*, 519 N.W.2d at 335. Because the statutes impose tax based upon a percentage of "the adjusted gross proceeds of gaming," the ultimate question for the Court is whether free play enjoyed by patrons of the Gaming Establishments can be counted as such "adjusted gross proceeds," *i.e.*, revenue or income to the Gaming Establishments and so be subject to tax.

Some of the terms under consideration are statutorily defined. SDCL § 42-7B-4(6) defines "gaming" as "limited card games and slot machines as allowed and regulated by this chapter." The term, "adjusted gross proceeds," is defined as "gross proceeds less cash prizes." *See* SDCL § 42-7B-4(1). Thus, taxing the adjusted gross proceeds of gaming makes common sense in the context of taxing net income to the Gaming Establishments – the tax is imposed upon monies received from gaming by the Gaming Establishments less monies paid out from the gaming by the Gaming Establish-ments. Chapter 42-7B does not define the term, "gross proceeds." The term "bet" is defined as "an amount placed as a wager in a game of chance." *See* SDCL § 42-7B-4(2). Additional relevant definitions are set out in the Deadwood gaming regulations promulgated under Chapter 42-7B.[2]

[2] The Gaming Establishments are regulated under A.R.S.D. 20:18, which regulations were promulgated by the South Dakota Commission on Gaming, with authority granted by the Legislature through SDCL § 42-7B-7.

Interpreting and applying these statutes and regulations results in accord with the common sense about taxing net gaming income described above – free play cannot constitute adjusted gross proceeds of gaming, *i.e.*, net gaming income, to the Gaming Establishments, as a matter of law, because it does not fit within the necessary statutory and regulatory definitions. Although "gross proceeds" is not a statutorily defined term within SDCL, Ch. 42-7B, by its plain meaning, it must require some sort of actual, measurable income or payment to the Gaming Establishments. For example, the Merriam-Webster dictionary defines "proceeds" as "the total amount brought in <the *proceeds* of a sale>; the net amount received (as for a check or from an insurance settlement) after deduction of any discount or charges." *See* http://www.merriam-webster.com/dictionary/proceeds. The plain meaning of gross proceeds, as an otherwise undefined term, means the Gaming Establishments must receive some sort of literal, measurable income. *See also* SDCL§ 42-7A-24 (defining "net proceeds" as "funds in the lottery operating fund which are not needed for the payment of prizes, lottery expenses, and total retained earnings up to one and one-hale million dollars cash deemed necessary by the executive director and commission for replacement, maintenance, and upgrade of business systems, product development, legal and operating contingencies of the lottery"); *United States v. Scialabba*, 282 F.3d 475 (7th

Cir.), *cert. denied*, 537 U.S. 1071 (2002) ("proceeds" of illegal gambling were the net income or profits of the business); *United States v. Simmons*, 154 F.3d 765 (8th Cir. 1998) ("proceeds" were gross receipts of the illegal activity).

Similarly, the term "gross receipts" in the context of another state tax, *i.e.*, sales tax, does not include "[d]iscounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a retailer and taken by a purchaser on a sale." *See* SDCL § 10-45-1.16. Free play is analogous to these in-store coupons, which are expressly excluded from the gross receipts of stores. Neither the Gaming Establishments, nor the stores receive any actual money equivalent of those in-store coupons, *i.e.*, dollar-for-dollar "in the till," of the free play or in-store coupon. Rather, free play and in-store coupons operate as a promotion to bring in customers and effectively act as a reduction in price of the product being purchased by the customer – a grocery store customer with an in-store coupon for soda may buy the soda at a reduced price, and a gaming establishment patron may partake of free plays of the slot machines. In neither of these instances are the establishments receiving any cash or actual income from the in-store coupon or free play.

When the free play credits or coupons are played in the slot machines or at the tables, the Gaming Establishments cannot fairly be said to be receiving the cash equivalent of the credits or coupons played. Any patron could simply

enjoy the free play credit or coupon and then walk away from the slot machine or table without paying any money to the Gaming Establishments. While the Gaming Establishments hope free play will attract patrons to spend money at their businesses, there is no guarantee of free play resulting in actual income to the Gaming Establishments.

As the statutes in SDCL Ch. 42-7B do not define the term "gross proceeds," they also do not define the term "free play." However, free play is not left an entirely undefined term. A South Dakota regulation specifically defines "free play" as "in relation to promotional items, the use of a coupon that is issued to a patron by an establishment for play for which no bet is required." *See* A.R.S.D. 20:18:01:01(11). This regulation thus defines the very free play at issue here. The Department seeks to tax the credits shown on the free play cards or coupons as literal, "dollar-for-dollar" income to the Gaming Establishments. This approach not only fails common sense – a patron sliding a free play card or coupon into a slot machine to enjoy free play is not paying any cash to the gaming establishment so as to result in an equivalent, measurable amount of revenue or dollars and cents of income to the gaming establishment – it also fails to apply the plain meaning of the relevant statutes and regulations.

"Free play" is that "for which no bet is required." *See* A.R.S.D. 20:18:01:01(11). The "free play" definition thus dovetails with the statutory definition of bet, which dictates that a bet requires a "wager in a game of chance." *See* SDCL 42-7B-4(2). There is no wager or game of chance involved in free play, not only due to the corresponding definition of free play, but also because a "wager" is "a sum of money or thing of value risked on an uncertain occurrence." *See* A.R.S.D. 20:18:22:01(5). When a patron inserts a free play card or coupon into a slot machine, that patron is not making a bet (by definition), not risking any sum of money and, not risking something of value to the patron on an uncertain occurrence, as the patron may not use the free play card for other purposes or allow another person to use it.

Free play is not redeemable for cash, merchandise, or other promotional offers and may be used only by the patron to whom it is given. Because the patron risks no money or thing of value, free play cannot satisfy the definition of a wager, or, accordingly, a bet. *See also* A.R.S.D. 20:18:01:01(11) (defining free play as something for which no bet is required). The Circuit Court erroneously postulated that free play is a thing of value by interjecting speculation that is not a matter of the settled record, *e.g.*, stating that "[s]ome casinos award 'points' for play and if a patron plays on a slow night, he or she gets double points towards free play …." CR 142 at p.12. This scenario was

not a matter of record at summary judgment. Summary judgment must be supported by the facts in the record, not speculation about what facts may or may not exist outside the record. *See e.g.*, *Hass v. Wentzlaff*, 2012 S.D. 50, ¶¶ 14-18, 816 N.W.2d 96, 101-02; *Estate of Elliott ex rel. Elliott v. A&B Welding Supply Co., Inc.*, 1999 S.D. 57, ¶ 27, 594 N.W.2d 707, 711 (to overcome a properly supporting motion for summary judgment, a non-moving party "must substantiate his allegations with 'sufficient probative evidence [that] would permit a finding in [his] favor on more than mere speculation, conjecture, or fantasy.' " *Himrich v. Carpenter,*1997 SD 116, ¶ 18, 569 N.W.2d 568, 573 (citing *Moody v. St. Charles County,* 23 F.3d 1410, 1412 (8th Cir.1994) (citations omitted))).

This error was compounded by the Circuit Court's reasoning that free play is a thing of value because its "value for the customers is in its potential to become money, and its value for the casinos is in its possibility of enticing patrons to money, which also translates to money." CR 142 at p.12. This conclusion is unsupported by any legal authority or factual basis in the record, and, as a matter of logical hypothesis, proves too much. Under this reasoning, almost anything – from the Gaming Establishments' advertising to attract patrons to the patrons' "investment" of time spent in the Gaming Establishments – is a thing of value and, therefore, a part of the statutory and

regulatory definition of "wager." This line of reasoning would result in nothing being able to satisfy the definition of "free play."

It must be recalled that "free play" is that "for which no bet is required," *see* A.R.S.D. 20:18:01:01(11), a "bet" requires a "wager in a game of chance," *see* SDCL § 42-7B-4(2), and a "wager" is "a sum of money or thing of value risked on an uncertain occurrence." *See* A.R.S.D. 20:18:22:01(5). Thus, "free play" cannot, by definition, include an occurrence when a thing of value is risked. If a "thing of value" is as nebulous as a patron's time in a gaming establishment or a patron's hope that the free play is a "thing of value" because it has a "potential to become money," *see* CR 142, at p. 12, then the term "free play" is rendered a nullity. *See Peterson v. Burns*, 2001 S.D.126, ¶ 30, 635 N.W.2d 556, 567-68 (the Court will not interpret a statute so as to render it meaningless). The Court's hypothesis about what can constitute a "thing of value" also varies from the gaming regulations, as they implement the gaming statutes.

The calculation of "adjusted gross proceeds" necessarily depends upon what is included in "gross proceeds." *See* SDCL§ 42-7B-4. For slot machines, the gaming regulations define "gross revenue"[3] as "drop less fills to the

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[3] Although SDCL § 42-7B-4 uses the term "gross proceeds," A.R.S.D. 20:18 does not use or define that particular term. Rather, the regulations use the term "gross revenue" without

machine jackpot payouts, hand pay credit lockups, and vouchers issued. . . ." *See* A.R.S.D. 20:18:22:12. The gaming regulations then define "drop" as "the total amount of money, chips, and tokens removed from the drop boxes." *See* A.R.S.D. 20:18:01:01(8). A "[c]hip" is "a nonmetal or partly metal representative of value, redeemable for cash, issued and *sold by a licensee* for use at gaming," and a "[t]oken" is "a metal representative of value, redeemable for cash, issued and *sold by a licensee* for use at gaming." *See* A.R.S.D. 20:18:20:01 (emphasis added). Thus, not only do the regulations explicitly define free play as a promotional item, not a bet or a wager, the regulations also exclude free play from being counted in the drop because free play is credits represented by a plastic card or coupon *given* to patrons; it is not money, a chip *sold* by a licensee, or a token *sold* by a licensee. *See* A.R.S.D. 20:18:01:01(8); A.R.S.D. 20:18:20:01. Therefore, free play is not a part of the drop and, *ergo*, cannot be included in the gross revenue.

The Department has previously argued that free play is essentially a computerized token, but this disregards the definitional requirement that a

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explaining the switch in terminology. Considering the statute and regulations together as a whole, presuming the result was not intended to be absurd or unreasonable, the fact that the term "gross revenues" is used and defined, while "gross proceeds" is not even mentioned in the regulations for these purposes leads to a fair inference that the two terms are intended to mean the same thing. *See Martinmaas v. Engelmann*, 200 S.D. 85, ¶ 49, 612 N.W.2d 611. Additionally, in this case, the Department has previously referenced A.R.S.D. 20:18:22:12,

token be sold by a licensee. None of the Gaming Establishments sell free play, and patrons cannot buy free play. Free play is a promotion *given* to attract patrons. Because the Gaming Establishments do not sell free play, it cannot, by definition, be a token which could be counted as part of the drop.

Because free play does not make up a part of the drop, it cannot be included in gross revenue. *See* A.R.S.D. 20:18:22:12. The Department has argued that the Gaming Establishments may seek to deduct free play from the gross revenue by arguing free play is a part of the fill and has asserted that A.R.S.D. 20:18:18:26[4] establishes free play is not deductible from the gross revenue of a slot machine. *See* CR 142 at p. 9. This argument, however, fails to recognize that free play is, by definition, never a part of the drop or the gross revenue in the first place. *See* A.R.S.D. 20:18:01:01(8); A.R.S.D. 20:18:20:01. Further, A.R.S.D. 20:18:18:26 speaks to bonus awards, payments, and promotional awards. It does not use the term free play, which is a separately,

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the definition of "gross revenue," showing the Department agrees "gross revenue" means the same thing as "gross proceeds," as defined by SDCL § 42-7B-4(1).

[4] A.R.S.D. 20:18:18:26 provides, in pertinent part, "[p]romotional and bonus systems are comprised of gaming devices that are configured to participate in electronically communicated promotional and bonus award payments from an approved host system. Bonus awards are based on a specific wager or specific event and are available to all patrons playing bonused slot machines. Payouts as a result of a bonus event are a deductible event in the adjusted gross revenue calculation. Promotional awards are additional features that entitle players to special promotional awards based on patrons play activity or awards gifted by the casino to guests. Promotional awards are not a deductible event in the adjusted gross revenue calculation. . . ."

specifically defined term. In considering the regulations together, the Court should not only interpret them to be "harmonious and workable," the Court may presume that the body promulgating the regulations was aware of the language used in each specific section; and so, if the regulations use different terms, the different terms refer to different things. *See Moore v. Michelin Tire Co., Inc.*, 1999 S.D. 152, ¶ 16, 603 N.W.2d 513, 518-19 (citations omitted).

To concur with the Department's argument would require the Court to add language, *i.e.*, the term, free play, to A.R.S.D. 20:18:18:26.[5] This is not appropriate statutory/regulatory interpretation and construction. The South Dakota Supreme Court has stated, "'[o]rdinarily, we may not, under the guise of judicial construction, add modifying words to the statute or change its terms.' *State v. Franz,* 526 N.W.2d 718, 720 (S.D. 1995). 'In construing a statute, it is always safer not to add to or subtract from the language of a statute unless imperatively required to make it a rational statute.' 2A *Sutherland Statutory Construction* § 47.38 (5th ed 1992)." *City of Sioux Falls v. Ewoldt*, 1997 S.D. 106, ¶13, 568 N.W.2d 764, 767. Thus, the Court should not add the

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[5] In fact, the Colorado Supreme Court expressly distinguished its statutory definition of the term "adjusted gross proceeds" from that in South Dakota's gaming statutes when it concluded that a Colorado gaming regulation, which included promotional payouts to players as nondeductible from adjusted gross proceeds, did not exceed the constitutional authority of the gaming commission to implement regulations under the gaming statutes. *See Tivolino Teller House, Inc. v. Fagan*, 926 P.2d 1218 (Colo. 1996).

term, free play, to A.R.S.D. 20:18:18:26 to consider whether free play may be deductible from gross revenues. This is particularly true in light of the Court's responsibility to construe statutes and regulations as a whole and to presume that the result of such construction should not be absurd or unreasonable – when the regulatory definitions preclude free play from being counted as a part of the drop which makes up gross revenues, in the first place, there is no reason to add language to A.R.S.D. 20:18:18:26 to reach the Department's argument about whether free play is subsequently deductible from gross revenue. Free play is not included in the gross revenue of slot machines in the first instance.

The Department has also argued that A.R.S.D. 20:18:20:02:01 prohibits free play from being deducted from gross revenues. *See* CR at pp. 11-12. A.R.S.D. 20:18:20:02:01 reads:

> A licensee who engages in promotions to increase business and gaming at the licensee's business may not deduct payouts made pursuant to the promotion from adjusted gross income except for money, prizes, or tokens paid at face value directly to a patron as the result of a specific wager. A specific wager requires two or more persons to stake something of value on an event, the outcome of which is uncertain. If only one party risks something of value, there is no wager.

This argument regarding deductibility from gross revenue continues to ignore the definitions that preclude free play from being part of the drop or the gross revenue in the first place and fails to recognize this regulation addresses

deductions of "*payouts* made pursuant to the promotion from adjusted gross income," not to any purported deduction of free play credits.

Additionally, A.R.S.D. 20:18:20:02:01 accords with the recognition that a wager requires two or more persons to risk something of value, such that "[i]f only one party risks something of value, there is no wager." *Id.* This recognition coincides with the statutory and regulatory definitions of "bet" and "wager." *See* SDCL 42-7B-4(2); A.R.S.D. 20:18:22:01(5). Accordingly, argument about whether A.R.S.D. 20:18:20:02:01 includes exceptions and how strictly exceptions should be construed are beside the point when the regulation addresses deductibility of payouts, not free play credits or coupons.

While the Department and the Circuit Court focused upon deductibility from gross revenue, *see* CR 142 at pp. 9-10; the threshold issue is whether free play may be counted into gross revenue of slot machines in the first instance. Under the definitions of free play, gross revenue, bet, wager, drop, chip, and token, free play never goes into the gross revenue count. Because free play does not make up a part of the drop, it is not a part of gross revenue or gross proceeds. Because free play is not included in gross revenue or gross proceeds, the Court need not address whether it is deductible after gross revenue or gross proceeds are totaled.

Free play cannot, as a matter of law, become part of the Gaming Establishments' adjusted gross proceeds. Therefore, the gaming tax calculation cannot include free play. The Gaming Establishments respectfully request the Court to rule that free play should not be included in the calculation of the Gaming Establishments' adjusted gross proceeds and is, accordingly, not subject to the gaming tax which is based upon a percentage of the adjusted gross proceeds.

2. The Gaming Establishments may seek the declaratory relief they request.

The Circuit Court accepted an argument by the Department that this action is not an appropriate vehicle for the Court to declare that Plaintiffs may seek a refund of the gaming tax paid as a result of the Department's erroneous determination that free play is a wager. *See* CR 142 at pp. 6-8. Unfortunately, this argument is simply inapplicable to this case. When a party seeks declaratory relief, the fact that "payment under protest" or other tax refund procedures exist does not preclude the circuit courts from granting such declaratory relief. *See Dan Nelson Automotive, Inc. v. Viken*, 2005 S.D. 109, ¶¶ 16-18, 706 N.W.2d 239, 245-46.

The initial case cited by the Circuit Court and the Department, *Tracfone Wireless, Inc. v. South Dakota Dep't of Revenue and Regulation*, 2010 S.D. 6,

778 N.W.2d 130, *see* CR 142 at p. 7; actually concluded that a taxpayer seeking a refund of telecommunications gross receipts taxes *could* file an administrative appeal of the Department's denial of its refund claim, and the taxpayer was *not* limited to seek such relief through a payment-under-protest method. *See generally Tracfone*, 2010 S.D. 6, 778 N.W.2d 130. In fact, it appears that the arguments asserted by the Department in *Tracfone* to limit taxpayer relief are very similar to those it has asserted in the case at bar.

The Department has asserted that a taxpayer may seek a refund for illegally paid taxes only through the Refund and Abatement Statute, SDCL § 10-18-1, and the Protest and Suit Statute, SDCL § 10-27-2. *See* CR 142 at pp. 6-8. SDCL § 10-18-1 specifically concerns refund and abatement of property taxes, which are not at issue here. For example, *Lick v. Dahl*, 285 N.W.2d 594 (S.D. 1979) specifically concerned an appeal of assessments for collection of real property taxes.[6] Thus, statements from *Lick* to the effect that property owners may appeal assessments of the value of their property only through certain statutory avenues for relief, do not apply to refunds of other sorts of

[6] Other cases previously cited by the Department are also distinguishable because they dealt exclusively with property tax issues. *See Chicago, M., St. Paul & P.R.Co. v. Board of Comm'rs of Walworth County*, 248 N.W.2d 386 (S.D. 1976); *Salem Independent Sch. Dist. v. Circuit Court*, 244 N.W. 373 (S.D. 1932); *Riverview Props., Ltd. v. South Dakota State Bd. of Equalization*, 439 N.W.2d 820 (S.D. 1989).

taxes, like telecommunications taxes, *see Tracfone*, *supra*, or gaming taxes, like the case at bar.

In *Tracfone*, the Department argued that the payment-under-protest procedure, set forth at SDCL § 10-27-2 was the exclusive method to obtain a tax refund. *Tracfone*, *Tracfone*, 2010 S.D. 6, ¶ 1, 778 N.W.2d 130, 131. *Tracfone* rejected that argument, determining the taxpayer could administratively appeal the Department's denial of its gross receipts tax refund. *Id*. at ¶ 22. Tracfone had filed a refund request with the Department; the Department denied that request; and Tracfone appealed that denial under SDCL §10-59-5. *Id*. at ¶¶ 4-6. The Department argued the administrative appeal should be dismissed because the taxpayer's only avenue to seek a refund was through a payment-under-protest suit, as described by SDCL § 10-27-2. *Id*. at ¶ 6. The *Tracfone* Court ultimately held that the taxpayer could proceed through an administrative appeal process set forth in SDCL, Chapter 10-59, even though the telecommunications tax chapter was not expressly listed at SDCL 10-59-1.[7] *Id*. at ¶¶ 18-22. Thus, the Circuit Court erred in concluding the Gaming Establishments' action is not permitted merely because other avenues exist to seek refunds. This Court should not refuse the Gaming

Establishments' claims for declaratory relief on the basis of this argument about co-existing processes for refund claims.

3. This action is not controlled by prior decisions of the Gaming Commission.

The Circuit Court also undertook an extended survey of prior rulings of the South Dakota Commission on Gaming ("Gaming Commission"). *See* CR 142 at pp. 12-15. After acknowledging the Gaming Commission's prior determinations were not binding on the Circuit Court, the Circuit Court, nonetheless, described them as "helpful in determining the intent of [the gaming regulations]" and suggested the Circuit Court should defer to the Gaming Commission's interpretation of its regulations, citing *Krsnak v. South Dakota Dep't of Environmental and Natural Resources*, 2012 S.D. 89, ¶ 16, 824 N.W.2d 429, 436 (citing *State v. Guerra*, 2009 S.D. 74, ¶ 32, 772 N.W.2d 907, 916)). *See* CR 142 at p. 13. This citation is inapposite to the factual background of this case and prior Gaming Commission proceedings.

The Circuit Court indicated the Gaming Commission found that promotional awards were not to be deducted from the adjusted gross revenue calculation. *See* CR at p. 13. The Circuit Court went on to note that there are a

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[7] SDCL, Ch. 10-59 is the Uniform Administrative of Certain State Taxes, and it includes provisions for taxpayers to seek refunds of overpaid taxes. *See e.g.*, SDCL § 10-59-9, *et*

large number of gaming regulations. *Id*. Although the Gaming Commission may have made a determination of deductibility of promotional awards from adjusted gross proceeds, that does not mean the Gaming Commission also conducted an analysis of the more germane statutes and regulations reviewed above, including SDCL §§ 42-7B-28, 42-7B-28.1, 42-7B-4 (multiple definitions within subsections); A.R.S.D. 20:18:22:01 (multiple definitions within subsections); 20:18:22:12. Rather, the Gaming Commission was apparently interpreting A.R.S.D. 20:18:18:26, regarding deductions allowed from the calculation of adjusted gross revenue for promotional awards. *See* CR at p.12.

Further, the procedural context of this suit calls into question whether the Gaming Commission's prior decisions should receive such determinative deference – this is not an appeal from the rulings of the Gaming Commission, but a separate declaratory judgment action, with different parties. Even the Department has conceded it could not locate legal authority to support an argument that the Court and parties in this action are bound by the Gaming Commission's prior decisions. *See* HT at pp. 7-8. Further, although courts usually give agency's a reasonable range of discretion in interpreting and applying their regulations, such deference is not warranted when the agency

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seq.

interpretation or application is misplaced. *See Paul Nelson Farm v. South Dakota Dep't of Revenue*, 2014 S.D. 31,¶ 22, ___ N.W. 2d. ___, 2014 WL 2135971, *6. As explained above, the Gaming Commission's conclusions are misplaced.

The Circuit Court also cited *Sanford v. Sanford*, 2005 S.D. 34, 694 N.W.2d 283 for the proposition that because the state legislature has not amended the statutes involved in this case since the rulings of the Commission, the legislature felt no response to those rulings was necessary. *See* CR 142 at pp. 13-14. This proposition extends the *Sanford* holding beyond its appropriate limits. In *Sanford*, the Court was reviewing amendments to statutes and adoption of a uniform act. *Sanford*, 2005 S.D. 34, ¶¶ 15-20, 694 N.W.2d at 287-89. In doing reviewing the history of legislative changes, the *Sanford* Court noted, "[w]e presume the Legislature acts with knowledge of our judicial decisions." *Sanford*, 2005 S.D. 34, ¶ 19, 694 N.W.2d at 289 (citing *See In re State Highway Comm'n v. Wieczorek,* 248 N.W.2d 369, 372 (S.D.1976)). There is no indication or other legal authority to support the argument that this Court or the state legislature would hold agency rulings in the same regard.

Although recognizing this action is not controlled by the prior Gaming Commission rulings under *res judicata*, the Circuit Court nonetheless described this action, involving different parties and other statutes and regulations, as an

application for a fourth or fifth bite at the apple. *See* CR 142 at .p15. This description shows an undue and erroneous adherence to the prior, non-controlling rulings of the Gaming Commission. Rather than giving such precedential effect to the decisions of an agency, the Court should follow its normal rules of statutory interpretation and construction to conclude free play is not included within adjusted proceeds so as to be taxable income to the Gaming Establishments.

CONCLUSION

In accord with the forgoing, the Gaming Establishments respectfully request the Court to reverse the Judgment in favor of the Department and to remand this action to Circuit Court, with the direction to enter Judgment in favor of the Gaming Establishments.

Dated at Sioux Falls, South Dakota, this 6th day of June, 2014.

DAVENPORT, EVANS, HURWITZ & SMITH, L.L.P.

*/s/ Sandra Hoglund Hanson*______________

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REQUEST FOR ORAL ARGUMENT

Appellants request the Court hear oral argument in this matter.

*/s/ Sandra Hoglund Hanson*______________
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IN THE SUPREME COURT
STATE OF SOUTH DAKOTA

No. 27055

FIRST GOLD HOTEL, MINERAL PALACE HOTEL AND GAMING, and FOUR ACES GAMING, LLC,,

Plaintiffs and Appellant,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE AND REGULATION,

Defendant and Appellee.

APPEAL FROM THE CIRCUIT COURT
SIXTH JUDICIAL CIRCUIT
HUGHES COUNTY, SOUTH DAKOTA

THE HONORABLE MARK BARNETT
Circuit Court Judge

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IN THE SUPREME COURT
STATE OF SOUTH DAKOTA

No. 27055

FIRST GOLD HOTEL, MINERAL PALACE HOTEL AND GAMING, and FOUR ACES GAMING, LLC,,

Plaintiffs and Appellant,

v.

SOUTH DAKOTA DEPARTMENT OF REVENUE AND REGULATION,

Defendant and Appellee.

PRELIMINARY STATEMENT

In this brief, Plaintiffs and Appellants First Gold, Inc. ("First Gold"), Mineral Palace, LP ("Mineral Palace"), and Four Aces Gaming, LLC ("Four Aces") shall be hereinafter collectively referred to as "Plaintiffs" or "Casinos." Defendant and Appellee, State of South Dakota Department of Revenue and Regulation, will be referred to as "Defendant" or "Department." References to documents will be designated as follows:

Settled Record .... SR

Plaintiffs' Brief...PB

All document designations will be followed by the appropriate page number(s).

JURISDICTIONAL STATEMENT

Casinos appeal from a March 24, 2014, Judgment and Order. SR 144. Such Judgment and Order granted the State summary judgment on the merits and denied the summary judgment motion of the Casinos. SR 142, 144. Notice of Entry of Judgment and Order was provided on April 1, 2014 to the Casinos. SR 147-48. The Casinos filed their Notice of Appeal on April 14, 2014. SR 153. There is no contention this appeal is not properly before this Court as provided by SDCL § 15-26A-3.

STATEMENT OF LEGAL ISSUES AND AUTHORITIES

I

WHETHER FREE PLAY IS APPROPRIATELY INCLUDED WITHIN ADJUSTED GROSS PROCEEDS?

The Circuit Court ruled that free promotional play is part of the adjusted gross proceeds calculation.

Martinmaas v. Engelmann, 2000 S.D. 85, 612 N.W.2d 600

SDCL § 10-27-2

II

WHETHER SUMMARY JUDGMENT WAS APPROPRIATE BECAUSE DECLARATORY JUDGMENT ACTION IS NOT AUTHORIZED FOR REFUND ACTION OR RETROACTIVE RELIEF?

The Circuit Court ruled that the Casinos were improperly seeking refunds.

Tracfone Wireless, Inc. v. South Dakota Department of Revenue and Regulation, 2010 S.D. 6, 778 N.W.2d 130

III

WHETHER THE OUTCOME OF THIS ACTION IS CONTROLLED BY PRIOR RULINGS FROM THE SOUTH DAKOTA GAMING COMISSION?

The Circuit Court stated that though the prior rulings were not binding upon the Court, they were instructive.

Krsnak v. South Dakota Department of Envirnmental and Natural Resources, 2012 S.D. 89, 824 N.W.2d 429

STATEMENT OF THE CASE

The Casinos appeal the granting of summary judgment on the merits as moved by the Department. Such decision by the Circuit Court included the holdings that free promotional play is included as a part of the adjusted proceeds of gaming under SDCL, ch. 42-7B, and applicable rules and regulations.

Taxes on gaming revenues are collected pursuant to SDCL ch. 42-7B. Taxes assessed as per SDCL 42-7B-28 require "an eight percent gaming tax on the adjusted gross proceeds of gaming allowed in this chapter." SDCL 42-7B-28.1 assesses "an additional one percent tax on the adjusted gross proceeds of gaming."

Under authority granted by SDCL 42-7B-7, the Gaming Commission has adopted certain administrative rules concerning the treatment of free promotional play on adjusted gross gaming proceeds. These regulations, discussed in detail in the argument below, generally appear in ARSD Art. 20:18.

All three Plaintiffs have a "free play/promotional play" system in place. SR 75, ¶ 39. The Commission has not promulgated any rules or procedures by which the Casinos, or any other Deadwood Casinos, operate their promotional play programs. *Id.* at ¶ 40. There is no uniform system of rules or regulations in place in South Dakota that establishes how a "promotional play" promotion is to be run and as such, each Casino has the sole discretion as to how their "promotional play" system is run and when it is provided to a patron. *Id.* at ¶¶ 41-42.

The Department's position, based upon applicable laws and regulations, is that promotional play is not a deductible event when determining adjusted gross proceeds from gaming, and therefore the Casinos must pay tax on free promotional play.

Though the Casinos now wish to restyle their argument into something else, the Complaint filed sought a declaratory action seeking "a declaration that they are entitled to seek a refund of the gaming taxes erroneously paid…" which may or may not have meant those taxes currently due. SR 6. Further, the Casinos are requesting a refund for prior taxes paid as a retroactive relief. SR 7.

The Department filed a Motion for Summary Judgment on July 1, 2013, and the Casinos filed a cross motion on November 7, 2013. SR 81, 99. After briefing and oral argument, Honorable Mark Barnett of the Sixth Judicial Circuit issued a Memorandum opinion on March

13, 2014. SR 142. Such opinion granted summary judgment on the merits to the Department and denied such to the Casinos. SR 144.

STATEMENT OF FACTS

The parties generally agree as to the underlying facts. All three Casinos have a "free play/promotional play" system in place. SR 75. As characterized by the Casinos, promotional play

> provides free slot machine play to select patrons. The free play is stored on plastic playing cards. The player inserts the card into a slot machine and is able to use the free play. The free play offered cannot be redeemed for cash, merchandise, or other promotional allowance and can only be used by the person identified on the card. Players can win money by using the free play. The free play must be used within a specific period of time or it is lost.

SR 8. The promotional play at issue here works as follows: The promotional play is provided by the Casino to patrons who join a casino's "player's club."[1] These clubs allow players to accumulate "points" for playing casino slot machines, which can be redeemed for merchandise and cash-back. SR 44, 50, 57. This free promotional play is a promotion used by the respective Casinos to entice people to come into their establishments. SR 45, 51, 58.

While dealing with the facts of the case at bar, it is of import to note that this is not an issue of first impression in South Dakota. Approximately 6 years ago, the South Dakota Commission on Gaming

[1] First Gold's club is called the "Gold Club," Mineral Palace's club is called the "Players Club," and Four Aces' Club is called the "Cash Back Club."

("Commission") issued an administrative declaratory ruling (as authorized by SDCL 1-26-15) on precisely the issue as presented here on appeal. On May 7, 2007, BY Development, Inc., the owner of Cadillac Jack's Casino (not a party to this suit), filed a petition with the Commission requesting that the Commission declare and determine whether the use of promotional money known as "Cadillac Cash" should be counted in the determination of statistical drop for purposes of calculating gaming tax on gross revenues pursuant to SDCL 42-7B-28. SR 77, ¶ 13.

A contested hearing was held before the Commission on May 17, 2007. *Id.* at ¶ 14. The Commission issued its Declaratory Ruling and Findings of Fact and Conclusions of Law on June 11, 2007. SR 71.

The findings stated that Cadillac Cash was a promotional award pursuant to ARSD § 20:18:18:26 partly because Cadillac Cash money could not be cashed out, and must be played within an allotted time or it would expire and would no longer be available for play, even though the player must insert their own actual cash into the slot machine to make the Cadillac Cash available for play. *Id.* at ¶ 17. The Commission held that promotional awards are not a deductible event in the adjusted gross revenue calculation. *Id.* at 18. As such, the Commission found that the use of Cadillac Cash must be counted in the statistical drop and in the calculation of gaming tax on adjusted gross proceeds. *Id.* at ¶ 19.

Two years later, the Deadwood Gaming Association (hereinafter "DGA") filed a petition with the Commission to amend the Commission's rules in a manner that would eliminate free promotional play from the determination of adjusted gross proceeds. SR 65. All three Casinos were members of the DGA at the time this petition was filed. SR 46, 52, 58. The attorney for the DGA, (who had also represented BY Development, Inc), requested an accelerated hearing, because the Commission normally meets in March of each year. SR 73 ¶ 10. The DGA indicated that the reason for the accelerated hearing request was because the DGA wished to have time to draft legislation that would be provided to the 84th session of the South Dakota Legislature if the Commission ruled against the DGA. *Id.* at ¶ 11. The request for the accelerated hearing was granted by the Commission. *Id.* at ¶ 12.

On December 7, 2009, a contested hearing occurred. On December 11, 2009, the Commission denied the Petition for Rule Change. SR 62. The decision reiterated, again, that under rules and statutes then in effect, promotional or free play in slot machines was subject to the taxation on adjusted gross proceeds. *Id.* The same language exists in the current rules and statutes as the language at issue in 2009, as there has been no substantive change to the laws since the DGA hearing. *Id.* In addition, the 2009 Denial indicated that the change in rules as requested by the DGA would create a loss of

taxes in amounts ranging from $851,557 to $1,199,062 at a time when state and local governments were facing budget issues. *Id.* It is of import to note that during the 2009 legislative session, the Legislature passed SDCL § 42-7B-28.1 which imposed an additional one percent tax on the adjusted gross proceeds of gaming, thereby increasing the tax amount gaming establishments would be required to pay. SR 76.

Even though the DGA, of which the Casinos were a member, requested an accelerated hearing for the purposes of addressing the tax issue legislatively, the DGA did not provide, request, or recommend any legislation to the 84th session of the South Dakota Legislature in regards to "promotional play" being exempt from the determination and calculation of gaming tax on gross revenues. SR 73 ¶ 15. As of the end of the legislative session in 2013, neither the DGA nor any of the Plaintiffs jointly or severally had provided, requested, or recommended any legislation the South Dakota Legislature in concerning "promotional play" being exempt from the determination and calculation of gaming tax on gross revenues. SR 73 ¶ 16.

Throughout this time, and until 2011, the Casinos have been paying their taxes. Though the mechanism for protesting tax payments was available, the first Casino to pay any taxes under protest was Mineral Palace, which paid under protest on a check dated October 12, 2010 (after initiation of the suit which is subject to this appeal). SR 75, ¶ 34. First Gold then paid under protest on a check dated April 14,

2011. *Id.* at ¶ 35. Four Aces continues to pay their taxes by hand delivery to the Deadwood office of the Commission, and there continues to be no record of taxes paid under protest. *Id.* at ¶ 36.

None of the Casinos paid any taxes under protest from 2003 until October 12, 2010, with regard to taxes that would have been subject to the underlying lawsuit. *Id.* at ¶ 37. Further, as of December 2, 2013, the date of the Summary Judgment hearing, none of the Plaintiffs had commenced any tax protest litigation as per SDCL ch. 42-7B. SR 45, 51, 58, 75.

ARGUMENT

A. Standard of Review.

It is well settled that where no genuine issues of material facts exist, the circuit court may grant summary judgment on a question of law.

> Under [the Supreme Court's] familiar standard for reviewing summary judgments, we decide only whether genuine issues of material fact existed and whether the law was correctly applied. *Harms v. Northland Ford Dealers,* 1999 SD 143, ¶ 8, 602 N.W.2d 58, 61. Summary judgment is not the proper method to dispose of factual questions. *Harn v. Continental Lumber Co.,* 506 N.W.2d 91, 94 (S.D.1993). Only when fact questions are undisputed will issues become questions of law for the court. *Id.* We will affirm the trial court's decision if we find any legal basis to support it. *De Smet Ins. Co. of South Dakota v. Gibson,* 1996 SD 102, ¶ 5, 552 N.W.2d 98, 99; SDCL 15–6–56(c). Statutory and contract interpretation are questions of law reviewed de novo. *State Farm Mut. Auto. Ins. Co. v. Vostad,* 520 N.W.2d 273, 275 (S.D.1994).

Bozied v. City of Brookings, 2001 S.D. 150, 638 N.W.2d 264, 268.

As the facts of this case, again, are essentially undisputed, the issues arise from whether the Department has appropriately applied the statutes and regulations in regards to promotional play.

Summary judgment is authorized for the Department as per SDCL § 15-6-46(b) and (c). Summary judgment is properly granted "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact, and that the moving party is entitled to judgment as a matter of law." *De Smet Farm Mut. Ins. Co. of S. Dakota v. Gulbranson Dev. Co., Inc.*, 2010 S.D. 15, 779 N.W.2d 148, 154-55.

> Certain guiding principles on the use of summary judgment have evolved. They are: (1) The evidence must be viewed most favorable to the nonmoving party; (2) The burden of proof is upon the movant to show clearly that there is no genuine issue of material fact and that he is entitled to judgment as a matter of law; (3) Though the purpose of the rule is to secure a just, speedy and inexpensive determination of the action, it was never intended to be used as a substitute for a court trial or for a trial by jury where any genuine issue of material fact exists. (4) A surmise that a party will not prevail upon trial is not sufficient basis to grant the motion on issues which are not shown to be sham, frivolous or so unsubstantial that it is obvious it would be futile to try them. (5) Summary judgment is an extreme remedy and should be awarded only when the truth is clear and reasonable doubts touching the existence of a genuine issue as to material fact should be resolved against the movant. (6) Where, however, no genuine issue of fact exists it is looked upon with favor and is particularly adaptable to expose sham claims and defenses.

State, Dept. of Revenue v. Thiewes, 448 N.W.2d 1, 2 (S.D. 1989).

The gaming regulations in question deal with whether or not promotional free play is exempted from the adjusted gross proceeds calculation for taxing purposes.

> The question of whether statute imposes a tax under a given factual situation is a question of law. Statutes which impose taxes are to be construed liberally in favor of the taxpayer and strictly against the taxing body. Statutes exempting property from taxation should be strictly construed in favor of the taxing power.

Robinson & Muenster Associates, Inc. v. South Dakota Dept of Revenue, 1999 S.D. 132, 601 N.W.2d 610, 612. "The words in such statutes should be given a reasonable, natural, and practical meaning to effectuate the purpose of the statute." *Estate of Zoss v. South Dakota Dept of Revenue*, 2001 S.D. 124, 635 N.W.2d 553, 554. There is no question that SDCL §§ 42-7B-28 and 42-7B-28.1 impose taxes upon the Casinos, and the language should be construed liberally in favor of the tax payer. The true issue is that the Casinos seek to exempt promotional free play from such imposition, thereby having such exemption language being strictly construed in favor of the Department.

B. Issues

I

FREE PLAY IS APPROPRIATELY INCLUDED WITHIN ADJUSTED GROSS PROCEEDS.

This Court noted in *Hartpence v. Youth Forestry Camp* that "[r]ules of statutory construction apply to administrative rules as well."

325 N.W.2d 292 (S.D. 1982). As applied to both codified laws and statutory construction are as follows:

> Questions of law such as statutory interpretation are reviewed by the Court de novo.... The purpose of statutory construction is to discover the true intention of the law which is to be ascertained primarily from the language expressed in the statute. The intent of a statute is determined from what the legislature said, rather than what the courts think it should have said, and the court must confine itself to the language used. Words and phrases in a statute must be given their plain meaning and effect. When the language in a statute is clear, certain and unambiguous, there is no reason for construction, and the Court's only function is to declare the meaning of the statute as clearly expressed. Since statutes must be construed according to their intent, the intent must be determined from the statute as a whole, as well as enactments relating to the same subject. But, in construing statutes together it is presumed that the legislature did not intend an absurd or unreasonable result. When the question is which of two enactments the legislature intended to apply to a particular situation, terms of a statute relating to a particular subject will prevail over the general terms of another statute.

Martinmaas v. Engelmann, 2000 S.D. 85, 612 N.W.2d 600, 611.

Further, the Commission has ability to promulgate rules, and the rules challenged by the Plaintiffs are clear in their intent and substance to tax "promotional play" as a part of gross proceeds. The Commission acquires its authority from Article III, § 1 of the South Dakota Constitution, which

> grants the legislature the power to enact laws. It is settled law that the legislature may delegate quasi-legislative duties to administrative agencies "so long as the applicable statute promulgates a legislative policy and outlines the standard to be followed in its execution." *Utah Idaho Sugar Co. v. Temmey,* 68 S.D. 623, 630, 5 N.W.2d 486, 489

> (1942); *Oahe Conservancy Subdistrict v. Janklow,* 308 N.W.2d 559, 563 (S.D.1981).

Black Hills Novelty Co., Inc. v. South Dakota Comm'n on Gaming, 520 N.W.2d 70, 73 (S.D. 1994).

Under the authority granted by SDCL § 42-7B-7, the Gaming Commission utilized its rulemaking power to enact the regulations challenged by the Casinos. Administrative rules should be given great weight by the court on questions of fact. This Court pointed out that administrative rules are presumed valid and have the full force of the law. *Sioux Falls Shopping News, Inc. v. Department of Revenue and Regulation*, 2008 S.D. 34, ¶ 24, 749 N.W.2d 522, 527.

ARSD 20:18:22:12 defines "Gross Revenue." Under this regulation, as it pertains to slot machines, gross revenue

> [E]quals drop less fills to the machine jackpot payouts, hand pay credit lockups, and vouchers issued. . . . The initial hopper is not a fill and does not affect gross revenue. The difference between the initial hopper load and the total amount that is in the hopper at the end of each month must be adjusted accordingly as an addition to or subtraction from the gross revenue for that month.

Thus, gross revenue is the money dropped into a slot machine minus its fills and its payouts to players. "Drop," is defined as "the total amount of money, chips, and tokens removed from the drop boxes" and is included in the gross proceeds. ARSD 20:18:22:12. Finally, "adjusted gross proceeds," as it applies to slot machine game is "gross proceeds less cash prizes." SDCL § 42-7B-4(1). The tax assessed is based on "adjusted gross proceeds."

If promotional play is not deductible from a slot machine's gross revenues, it must, by its nature, be considered part of the drop into a slot machine, as everything else (the fills and the payouts) is deductible under the gross revenue deduction established in ARSD 20:18:22:12.

However, the Commission has promulgated a rule that directly addresses the impact of promotional play on a casino's gross and adjusted gross revenues or proceeds. ARSD 20:18:18:26 states:

> Promotional and bonus systems are comprised of gaming devices that are configured to participate in electronically communicated promotional and bonus award payments from an approved host system. Bonus awards are based on a specific wager or specific event and are available to all patrons playing bonused slot machines. Payouts as a result of a bonus event are a deductible event in the adjusted gross revenue calculation. *Promotional awards are additional features that entitle players to special promotional awards based on patrons play activity or awards gifted by the casino to guests. Promotional awards are not a deductible event in the adjusted gross revenue calculation. The following procedures shall be adhered to in any slot machine promotional or bonus system.*

(Emphasis added.) This rule establishes by law that promotional play is not deductible in the calculation of adjusted gross revenue of a slot machine. The Casinos argue that this interpretation somehow forces this Court to add language, *i.e.* "free play" to the rule. This is unsupported, as the Commission defined "free play" as "in relation to promotional items, the use of a coupon that is issued to a patron by an establishment for play for which no bet is required." ARSD 20:18:01:01(11). Using the term "promotional item" within the definition of free play allows for the almost complete interchangeability

of the two terms. Reading "free play" into the rule requires neither addition nor subtraction from the language of the rules as the Casinos would argue, as the rule is already rational. *See City of Sioux Falls v. Ewoldt*, 1997 S.D. 106, ¶ 13, 568 N.W.2d 764, 767.

ARSD 20:18:18:26 and its statement that "promotional awards are not a deductible event in the adjusted gross revenue calculation" is clear, certain and unambiguous. Under the rules of statutory construction, it controls.

Further, the Casinos argue that promotional free play is not a "wager" under ARSD 20:18:20:02:01 and that promotional free play should therefore be deducted when determining a slot machine's gross revenue. SR 5-6, ¶¶ 22-24. By its nature, however, this argument conflicts with ARSD 20:18:18:26. If the promotional "award" (free play) is excluded from the "drop" (thereby including it in the "fill," or truly in any other manner), it is a deductible event in the calculation of a slot machine's revenues. ARSD 20:18:18:26 prohibits promotional "awards," which would include free plays on a slot machine, from being deductible events. The rules of statutory construction require that all rules be considered as a whole in determining their meaning. *Martinmaas*, 2000 S.D. 85 at ¶ 49, 612 N.W.2d at 611.

Additionally, even the regulation relied on by the Casinos' Complaint (ARSD 20:18:20.02:01) contains an identical prohibition. It states as follows:

> **Promotional items—Definition of specific wager**.
>
> A licensee who engages in *promotions to increase business and gaming at the licensee's business may not deduct payouts made pursuant to the promotion from adjusted gross income except for money, prizes, or tokens paid at face value directly to a patron as the result of a specific wager.* A specific wager requires two or more persons to stake something of value on an event, the outcome of which is uncertain. If only one party risks something of value, there is no wager.

(Emphasis added). The Complaint asserts that a "wager" as defined in ARSD 20:18:20.02:01 does not occur when promotional play is used, and therefore that the prohibition against deducting "payouts made pursuant to the promotion" (the promotional play) does not apply. SR 5, ¶ 23.

This interpretation of the impact of whether a "wager" has occurred under ARSD 20:18:20.02:01 is faulty as a matter of law. Whether a wager occurs impacts only the exception in ARSD 20:18:20.02:01 ("except for money, prizes or tokens paid at face value directly to a patron as a result of a specific wager"), not the general provision itself. The general provision is "A licensee who engages in promotions to increase business and gaming at the licensee's business may not deduct payouts made pursuant to the promotion from adjusted gross income. . . ."

It is a basic rule of statutory construction that the statutory exceptions are to be strictly construed; "they extend only so far as their language fairly warrants, and all doubts should be resolved in favor of

the general provision rather than the exception." *Olsen v. City of Spearfish*, 288 N.W.2d 497, 500 (S.D. 1980). The restriction "as a result of a specific wager" applies only to the exception clause[2] it follows, not the general provision of ARSD 20:18:20.02:01. Indeed, the restriction "as a result of a specific wager" makes no sense if applied to the general provision "may not deduct payouts made pursuant to the promotion from adjusted gross income." A statute or rule may not be construed in a manner that renders it absurd or unreasonable. *Martinmaas*, 2000 S.D. 85 at ¶ 49, 612 N.W.2d at 611.

Further, proper statutory construction requires that the rules be construed as a whole, with all enactments relating to the same subject being given effect. *Id.* This interpretation of ARSD 20:18:20.02:01 is consistent with the regulatory scheme established by the rules, particularly ARSD 20:18:18:26 which likewise prohibits promotional prizes like free play to be an adjustment to a slot machine's revenues. As a result, the claims made by the Casinos fail as a matter of law: regardless of whether a "wager" occurs when promotional free play is played, the law in ARSD 20:18:18:26 and ARSD 20:18:20.02:01 establishes that the Casinos may *not* deduct the promotional play as an adjustment to gross income.

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[2] If a wager has not occurred when promotional play is being played and a player wins and cashes out, the casino cannot deduct the money paid to the patron for the "win" under this rule because the limit ("as a result of a specific wager") on the exception clause ("except for money, prizes or tokens paid at face value directly to a patron") was not met.

Alternatively, the Casinos' assertion that the promotional play is "free" and therefore not a wager (SR 5-6, ¶¶ 22-24) is incorrect. As previously explained, the promotional play is provided by the Casinos to patrons who join a "players club." These clubs allow players to accumulate "points" for playing casino slot machines; these points can be redeemed for merchandise and cash-back. SR 57, 50, 44. A player who uses the points for promotional play cannot then use those same points for merchandise or cash-back; once they are expended, they are gone. The player is therefore wagering something of value (points that can be used for other endeavors) when the player uses the points for promotional free play.

The Casinos argue that the Circuit Court erroneously postulated that free play is a thing of value by interjecting speculation that is not a matter of the record. PB 13. This is entirely untrue. The record is replete with admissions from the Casinos that free play is a thing of value.[3] The Casinos' position that there is nothing more than "speculation, conjecture, or fantasy" on the part of the Circuit Court is

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[3] The Casinos admitted that:

1. promotional play points count towards club promotions when used in slot machines;
2. the clubs allow for cash back on points accumulated;
3. the clubs allow for redemption of points for merchandise and also cash back.

see SR 44, 50, 56.

nonsense. *Himrich v. Carpenter*, 1997 S.D. 116, ¶ 18, 569 N.W.2d 568, 573.

The Casinos then find fault with the Circuit Court's reasoning that free play is a thing of value because its "value for the customers is in its potential to become money, and its value for the casinos is in its possibility of enticing patrons to [spend] money, which also translates to money." SR 142, p.12. Casinos state this "conclusion is unsupported by any legal authority or factual basis in the record, and, as a matter of logical hypothesis, proves too much." PB 13. Again, there are facts and admissions on the record indicating that promotional play has a value to the Casinos, and there can be little logical argument that the promotional play does not have a value to a patron.

In a hypothetical situation, a Casino offers two patrons one free spin each on a slot machine. Presumably, neither would turn down such an offer by exclaiming "that spin does not have a value!"

If one makes it over the first logical hurdle that the patron will not turn down the free spin, one must then look to the value of the potential of the free spin. Patron 1 steps up to the machine, and has one of two possibilities: either the spin generates money, or it does not. If Patron 1's spin is successful, money or further spins are awarded, and they now have a thing with specific value. Should the spin be unsuccessful, there may be no further value. The crux of the question

is then "Is Patron 2, who has not used his spin, in a similar or different position than that of Patron 1?" The answer is "yes." Patron 2 holds a thing of value, as it could be turned into money, while Patron 1 has already used his spin and holds nothing. It takes neither case law nor statutory authority to determine that something has a value.

"Drop" is defined as "[t]he total amount of money, chips, and tokens removed from the drop boxes." ARSD 20:18:01:01(8). The "drop" is the gross revenue of a slot machine; it is adjusted to determine how much tax is to be assessed. Promotional play is in essence a computerized token: it is electronically taken from a players' club card as a token by the slot machine for use by the player. It has a value (which is exactly why it is an effective promotional device). It leverages the value of "free play" in a wager to realize a possible win from the machine. When a players' club player is using points from the players' card to play, the player is wagering the value of the points in other merchandise, cash back, discounts, etc. In some cases a player may leverage his own previous wagers made on slot machines in that Casino to accumulate points he is spending. In all cases, something of value is being wagered.

Further, the Casino provides the argument that promotional "'free play' is that 'for which no bet is required,' . . . a 'bet' requires a 'wager in a game of chance,' . . . and a 'wager' is a 'sum of money or thing of value risked on an uncertain occurrence.'" PB 14. Therefore,

as the Casino argues, for something to be a thing of value by virtue of it having "the potential to become money," it would make the definition of promotional free play null. It is difficult to follow this logic, as the only thing it makes null is the Casinos own argument that promotional free play should not be considered in the consideration of adjusted gross proceeds. Recall that both ARSD 20:18:18:26 and ARSD 20:18:20:02:01 do not allow for promotional play to be deducted from adjusted gross proceeds. For promotional free play to be included in the calculation of adjusted gross proceeds fits neatly in line with existing rules, and does not become "null" as argued by the Casinos. For the Casinos to ask that promotional free play be exempted from the tax requires that the rules be "strictly construed in favor of the taxing power." *Zoss*, 2001 S.D. 124 at ¶ 5, 635 N.W.2d at 554.

Thus, contrary to the assertions made by the Casinos, a wager occurs when promotional free play is being played, and the prohibition on deducting the promotional free play from the adjusted gross income of a slot machine established by ARSD 20:18:20.02:01 applies. As previously explained, even if a wager is not occurring when promotional free play is being used, the prohibition established by the rule applies regardless. As such, the Casinos claims must be rejected.

The standards of statutory construction require that the Commission's rules be read as a whole, with words and phrases being given their clear meaning. ARSD 20:18:18:26 and ARSD

20:18:20.02:01 specifically and clearly address the issue raised by the Casino, and state that promotional free play is not a deductible event. The Casinos' attempt to alter this clear language by arguing that a "wager" under ARSD 20:18:20.02:01 is not occurring when promotional free play is used, is contrary to the specific language of both that rule itself, as well as the other applicable rules. Promotional free play is appropriately included, and not exempted, within the adjusted gross proceeds so as to constitute taxable income to the Casinos.

II

SUMMARY JUDGMENT WAS APPROPRIATE BECAUSE DECLARATORY JUDGMENT ACTION IS NOT AUTHORIZED FOR TAX REFUND ACTION OR RETROACTIVE RELIEF.

In their Prayer for Relief, Plaintiffs requested an Order and Judgment "[d]eclaring that the Plaintiffs are entitled to seek a refund of the gaming tax paid as the result of the Defendants' erroneous determination that free slot machine play is a wager." This is not the proper way to seek a refund.

This Court has held:

> The Legislature has recognized the potentially crippling effect untimely taxpayer refund requests could have on taxing districts. *Miner v. Clifton,* 30 S.D. 127, 137 N.W. 585, 586 (1912). As a result, the Legislature has in the past crafted narrow exceptions that permit a tax payer to obtain a refund in a manner that does not endanger the fiscal integrity of taxing districts. *Security Nat'l Bank v. Twinde,* 52 S.D. 352, 217 N.W. 542, 543 (1928) (citing Rev. Code 1919, § 6813, which enumerated six narrow exceptions for which a tax refund may be obtained versus the payment-under-protest method in which a suit must be filed); *McArdle v. Robertson,* 70 S.D. 545, 547, 19 N.W.2d 576,

> 576 (1945) (citing SDC 57.0901 (1939) permitting refund of voluntarily paid taxes when paid under protest and civil suit commenced within thirty days is utilized).

Tracfone Wireless, Inc. v. S. Dakota Dept. of Revenue & Regulation, 2010 S.D. 6, 778 N.W.2d 130, 136-37. The Legislature has not included any such narrow exceptions in SDCL § 42-7B.

The Casinos misinterpret *Tracfone's* decision and ask this Court to throw the barn doors wide open and allow for all-comers to circumvent the laws designed to protect a taxing district. *Tracfone* believed it "miscalculated and then overpaid its telecommunication gross receipts tax during the period of April 2004 to March 2007." *Id.* at 131. It applied for a refund through forms provided by the Department of Revenue, and then sought an administrative hearing when the claim was denied. The Supreme Court held that "SDCL 10-33A-12 expressly authorizes appeals under SDCL ch. 1-26 of a denial of a refund request for overpayment of telecommunications gross receipts taxes." Neither of those statutes is at question here, nor is the question of an administrative appeal from a Department denial. In fact, it would appear that one of the few avenues not taken by the Casinos was a request for refund through the Department. It is irrelevant that this Court indicated that an appeal to the Office of Hearing Examiners from a refund request was appropriate, as that did not occur, as here the Casinos "[sought] a refund of the gaming taxes . . . paid as the result of the [Department's] determination that fee slot machine play is

a wager" through declaratory relief. SR 5. They made no attempt to seek a refund from the Department through the means used in *Tracfone*.

The South Dakota Supreme Court unanimously held in *Lick v. Dahl* that there are only "two *exclusive* methods by which an aggrieved taxpayer may seek recovery for alleged illegal taxes paid. They are the Refund and Abatement Statute, SDCL 10-18-1, and the Protest and Suit Statute, SDCL 10-27-2." 285 N.W.2d 594, 599 (S.D. 1979). As SDCL 10-18-1 deals with property taxes, it is not applicable here.

SDCL 10-27-2 provides that

> Any person against whom any tax is levied or who may be required to pay the tax, who pays the tax prior to the tax becoming delinquent and under protest to the treasurer authorized to collect the tax, giving notice at the time of payment of the reasons for such protest may, at any time within thirty days thereafter, commence an action against such treasurer for the recovery of the tax in any court of competent jurisdiction. If the court determines that the tax was wrongfully collected, in whole or in part, for any reason going to the merits of the tax, the court shall enter judgment accordingly, and such judgment shall be paid in preference to any other claim against the county, upon the final determination of the action. A pro rata share of the money so refunded shall be charged to the state and each taxing district which may have received any part of the tax. The right of appeal shall exist for both parties as in other civil actions.

The purpose of the protest and suit remedy is to permit taxing districts which have made levies for their needs to receive the contemplated revenue whereby they will not be crippled in operation, and disputes with reference to the legality thereof are to be deferred for

subsequent decision with the opportunity to make adequate provisions for refund if adjudged. *Chicago, M., St. Paul & P. R. Co. v. Bd. of Com'rs of Walworth County*, 248 N.W.2d 386, 389-90 (S.D. 1976) (quoting *Salem Independent School Dist. v. Circuit Court*, 60 S.D. 341, 244 N.W. 373 (1932)). The language of SDCL § 10-27-2 has existed "as written, since the Revised Code of 1919, § 6826." *Metro. Life Ins. Co. v. Kinsman*, 2009 S.D. 53, 768 N.W.2d 540, 543.

The South Dakota Supreme Court had the opportunity to review SDCL 10-27-2 in 1989 and again in 2009, wherein it stated "[w]hile we agree that this does indeed place an additional burden on a taxpayer seeking recovery and repayment of overpaid taxes, we do not believe that the statutes provide for any other remedy." *Metro. Life,* 2009 S.D. 53 at ¶ 18, 768 N.W.2d at 545 (quoting *Riverview Prop.[,Ltd.] v. Bd. of Equalization,* 439 N.W.2d 820, 823 (S.D.1989)). While Mineral Palace and First Gold wrote "paid under protest" on the payments in 2010 and 2011, respectively, they did not commence any actions against a treasurer within thirty days of making such protestation. Four Aces had paid in the past, and continues to pay their taxes by hand delivery, so at the time of the hearing there was no record of them "paying under protest," but regardless of any statements of protest, they too failed to commence any actions in a timely fashion "against such treasurer for the recovery of the tax in any court of competent jurisdiction." SDCL § 10-27-2. It is apparent that the Casinos were aware of the provisions

of SDCL § 10-27-2, as some of them began writing "paid under protest" on their payments, but failed to follow through with the remaining requirements of the section.

When following the statutorily proscribed methods in SDCL § 10-27-2, the protests and appeals have already been made, thereby assuring the Department, or taxing district, should not allocate the funds received from such tax without a proper plan to pay back the protestor should their protestations be found valid. The Casinos failed to follow such procedures, and beyond that, sought recovery of taxes paid years ago, as opposed to mere days. The funds received have long been spent.

Most telling is that the holdings of *Lick* and *Metro Life* explicitly discuss the danger that the Casinos attempted end run will cause to the taxing districts. In 2009 it was determined that the change of rules requested by the DGA would cause a loss of taxes ranging from "$851,557 to $1,199,062" a year. SR 75. For each following year, that amount continues to hold in excess of one million dollars. *Id.* For the Casinos to be able to seek a refund for multiple years would cause the taxing districts, which in this case includes the "State general fund, the Department of Tourism, and local entities" to be forced to provide refunds on exceptional amounts that have long been spent, not only in the past year, but for how ever many years the Casinos think they are entitled. *Id.*

By and of itself, summary judgment was properly granted on this issue.

III

THE OUTCOME OF THIS ACTION BEING CONTROLLED BY PRIOR RULINGS FROM THE SOUTH DAKOTA COMMISSION ON GAMING IS IRRELEVANT.

It should not be lost on this Court that the Casinos' issue statement asks whether this decision is controlled by prior decisions of the Gaming Commission and then immediately admits that the Circuit Court said it was not bound by the prior decisions. PB 21. With that being said, the Circuit Court did state that "an agency is usually given a reasonable range of informed discretion in the interpretation and application of its own rules when language subject to construction is technical in nature or ambiguous, or when the agency interpretation is on of long standing." SR 130 (citing *Krsnak v. South Dakota Dept. of Environment and Natural Resources*, 2012 S.D. 89, ¶ 16, 824 N.W.2d 429, 436 (remainder of citation omitted). As the Circuit Court points out, "[a] simple scan of the administrative regulations on gaming, particularly including [ARSD 20:18], reveals a mind boggling array of specialized rules. . ." *Id.*

Again, though the Circuit Court stated that the decisions of the Commission were not controlling, they were illuminative in understanding the gaming industry, which is a "highly regulated, specialized industry which garners legislative interest nearly every

year." *Id.* The Casinos then make an argument that even if the prior decisions were not exactly on point, making *Krsnak* not applicable, they dealt with appeals from rulings of the gaming commission, and not a declaratory judgment action as is the case at bar. They further indicate that those rulings of the Commission should not be given any deference because the parties were different.

Taking their second argument, that these are different parties, first, the requested rule change was brought by the DGA, of which all three of the Casinos were a member. SR 58, 52, 46. *McElhaney v. Anderson,* 1999 S.D. 78, ¶ 13, 598 N.W.2d 203, 206. This Court discussed res judicata in *Black Hills Jewelry Manufacturing Company v. Felco Jewel Industries* and found that it bars an attempt to re-litigate a prior determined cause of action by the parties, or one of the parties in privity to a party in an earlier suit. 336 N.W.2d 153, 157 (S.D. 1983). This Court ruled in *McElhaney* that "any claim over which an administrative agency had jurisdiction that is raised and rejected by the agency, is subsequently barred from being retried on the merits in the courts under the doctrine of res judicata." 1999 S.D. 78, 598 N.W.2d at 206. In determining who are parties in privity, the Court cited *Schell v. Walker* and concluded that the courts must "look beyond the nominal parties, and treat all those whose interests are involved in the litigation and who conduct and control the action or defense as real parties." 305 N.W.2d 920 (S.D. 1981).

While the doctrine of res judicata is specific in its barring of the same parties litigating a second lawsuit, that is not what is at question here. What is at question is whether a Court can give deference to prior holdings of an agency that have, on their face, similar questions with similar parties. The standards and logic applied in determining whether res judicata is applicable are at a minimum applicable in answering whether the situations are similar. Here, the Commission heard a rules change request from the DGA, which had as three of its members the First Gold, Mineral Palace, and the Four Aces. The specific rules change sought to make it explicitly clear that "free play" would **not** be included within adjusted gross proceeds as to constitute taxable income to casinos. This is exactly what the Casinos hoped to accomplish with their declaratory action. It takes only a small step to reach the conclusion that the Commission's reasons for denial of DGA's Petition for Amendment of Rules would be guiding in determining the "interpretation and application" of gaming regulations where the Casinos again ask the same question.

So, while the Court did not find itself bound to the prior rulings of the Commission, it did find it helpful in making its determination, as both the question and the parties that presented it are so similar as to appear indistinguishable.

CONCLUSION

The Circuit Court's ruling should be upheld, because the law is clear and unambiguous on the application of taxes as applied to the Casinos. "If any legal basis to support the court's ruling emerges [this Court] will affirm." *Garrett v. BankWest, Inc.,* 459 N.W.2d 833, 837 (S.D. 1990).

The Casinos' Prayer for Relief requested reimbursement of back taxes which they believe were unjustly collected. As stated above, a declaratory action is an inappropriate avenue for a tax refund, making this is a moot point, but should this Court decide otherwise, it is clear from well-settled law that no reimbursement of taxes is allowed by law unless the Casinos followed the proper procedures for contested payments. There is no dispute that the Casinos did not follow the proper procedures. As a matter of law, the Department was entitled to have Summary Judgment granted.

The Department respectfully requests that the trial court's judgment and sentence be affirmed.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

1. I certify that the Appellee's Brief is within the limitation provided for in SDCL 15-26A-66(b) using Bookman Old Style typeface in 12 point type. Appellee's Brief contains 7,278 words.

2. I certify that the word processing software used to prepare this brief is Microsoft Word 2010.

Dated this 23rd day of July, 2014.

____

Jeromy J. Pankratz
Assistant Attorney General

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 23rd day of July, 2014, a true and correct copy of Appellee's Brief in the matter of *First Gold Hotel, Mineral Palace Hotel and Gaming, and Four Aces Gaming, LLC v. South Dakota Department of Revenue and Regulation* was served via electronic mail upon Sandra Hoglund Hanson, Attorney at Law at shanson@dehs.com.

____

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IN THE SUPREME COURT
OF THE
STATE OF SOUTH DAKOTA

No. 27055

FIRST GOLD HOTEL, MINERAL PALACE HOTEL AND GAMING, and FOUR ACES GAMING, LLC,

Plaintiffs/Appellants,

vs.

SOUTH DAKOTA DEPARTMENT OF REVENUE AND REGULATION,

Defendant/Appellee.

Appeal from the Circuit Court
Sixth Judicial Circuit
Hughes County, South Dakota

The Honorable Mark Barnett, Presiding Judge

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ARGUMENT

According to the Department, the issue on this appeal is whether there is a tax exemption for free play – that is, whether free play is deductible from the taxable gross proceeds. This question is both inapt and unnecessary because free play is never included in gross proceeds at all, and, therefore, the question of whether it is subsequently a matter for deduction or exemption never arises. Even if it were necessary to determine whether free play is deductible under ARSD 20:18:18:26 and/or 20:18:20.02:01, the Department's construction is still incorrect. These regulations concern only the money going out of a casino to patrons; they do not address the question of money being brought in to a casino, which is how the Department wishes to treat free play.

Such treatment is not only fictitious, but illogical. Treating free play as income to a casino is like treating an in-store coupon or the difference between regular and sale prices as income to a retail store. Free play is a boon given to patrons in the hope they will come to a casino and give their gaming business to the casino. To treat free play as dollar-for-dollar income to a casino creates a legal fiction out of step with reality.

The Department also errs in claiming that this action is procedurally barred. The Gaming Establishments have agreed this is a declaratory judgment action, and no refund for past payment is contemplated within this litigation;

such an action is clearly permitted under this Court's precedent. Finally, the Department's insinuation that this action is barred by a gaming organization's 2009 request for a rules change or 2007 ruling involving a separate, unrelated party is without factual or legal foundation and presents an untimely attempt to raise an argument the Department previously conceded was without legal support.

The Department mistakes the standard of review

Because the Gaming Establishments do not argue that a particular exemption should be interpreted to include free play, the Department's assertion that the language of the applicable statutes should be construed in its favor is erroneous. As has been previously stated, the Gaming Establishments do not seek an exemption, but a declaration that tax may not be imposed because the matter at issue is not includable in the first place. Specifically, free play cannot be included in the Gaming Establishments' proceeds. Thus, the Court need not consider whether it is subsequently deductible from those proceeds before the gaming tax is imposed.

Consequently, ARSD 20:18:18:26 and 20:18:20.02:01 are not truly the subjects for interpretation, and the Department is entitled to no special favor. Instead, because the issue is one of imposition rather than exemption, and the statutes being construed are SDCL §§ 42-7B-28 and 42-7B-28.1, it is the

Gaming Establishments who are entitled to have the statutes construed liberally in their favor. *See National Food Corp. v. Aurora County Bd. of Comm'rs,* 537 N.W.2d 564, 566 (S.D. 1995).

Even if the issue before the Court were the interpretation of ARSD 20:18:18:26 and 20:18:20.02:01, the Department would not be entitled to have the regulation construed strictly in its favor. Nothing in the cited provisions creates an exemption or deduction. Instead, both regulations identify certain items that are *not* deductible. ARSD 20:18:18:26 states that "[p]romotional awards are not a deductible event in the adjusted gross revenue calculation." ARSD 20:18:20.02:01 says that a "licensee who engages in promotions to increase business may not deduct payouts made pursuant to the promotion from adjusted gross income." In other words, these regulations identify something that is included in the taxable total rather than something that is to be deducted. Since no exemption or deduction is being created, the Department should not receive the benefit of strict statutory construction.

In addition, the Department, like the Circuit Court, requests undue deference to the Gaming Commission's prior decisions. The question of agency discretion does not arise, because neither the Circuit Court nor this Court is being asked to review an agency decision. Again, the Gaming Establishments were not part of the 2007 ruling by the Gaming Commission or

the 2009 petition to change the rules, and neither of these decisions was being reviewed by the Circuit Court. "Whether a statute imposes a tax under a given factual situation is a question of law and thus no deference is given to any conclusion reached by the Department of Revenue or the circuit court. On questions of law, [this Court] may interpret statutes without any assistance from the administrative agency." *Paul Nelson Farm v. South Dakota Dept. of Revenue,* 2014 SD 31 ¶ 7, 847 N.W.2d 550, 553-54 (quotations omitted). Agency interpretations and discretion should not influence, let alone control, the decision on the questions at bar. The 2007 and 2009 decisions are not on appeal here and have no bearing on this action.

Deduction or exemption is not an issue because free play is never included in gross proceeds

Despite the Department's claims to the contrary, the Gaming Establishments have not argued that free play is deductible from gross proceeds or otherwise fits under an exemption statute. The Gaming Establishments' position, both in the Circuit Court proceeding and in this appeal, is that free play is not included in gross proceeds in the first place because its use by patrons does not provide income to the Gaming Establishments.

The Department asserts that if free play "is not deductible from a slot machine's gross revenues, it must, by its nature, be considered part of the drop into a slot machine." *See* Appellee's Brief at p.14. Since the drop from a slot machine is included in gross revenue under A.R.S.D. 20:18:22:12, the argument goes, anything that is drop must therefore be gross revenue. This argument neglects to consider that free play is, by definition, never actually a part of the drop.

The drop from a slot machine is "the total amount of money, chips and tokens removed from the drop boxes." *See* ARSD 20:18:01:01(8). The Department asserts that free play must be part of the drop because it is "in essence a computerized token." The term "token" is defined by regulation as "a metal representative of value, redeemable for cash, *and sold* by a licensee for use in gaming." *See* ARSD 20:19:20:01 (emphasis added). It is undisputed – the Gaming Establishments *do not sell* free play; they *give* free play to patrons for no consideration whatsoever, and free play has no transferrable value. *See* CR 106 at ¶¶ 10-11; 96 at ¶¶ 10-11; 111 at ¶¶ 11-12. It is also undisputed that free play is not redeemable for cash. Free play may be computerized, but the regulatory definition clearly demonstrates that free play cannot be a token, even in essence, because it is "free."

Nor may the Department argue that free play is a token because some casinos award points for play, which can be exchanged for merchandise. First of all, the Department fails to cite any portion of the record where it was established that the Gaming Establishments convert free play into points, which can then be exchanged for cash or merchandise. *See Nauman v. Nauman*, 336 N.W.2d 662, 664 (S.D. 1983) (stating, "[o]n appeal, the record and the transcript, if included in the record, imparts an absolute verity and is the sole evidence of the trial court's proceedings") (citation omitted).

Further, even if this assertion were a matter of record, the argument is beside the point. The definition of "token" specifically states that a token must be redeemable for cash, not that its use at the casino will entitle the player to intangible points that may eventually be exchanged for something with cash value. The record establishes that free play cannot be redeemed for cash, merchandise, or other promotional offers. *See* CR 106 at ¶ 7; 96 at ¶ 7; 111 at ¶ 8. Free play is not sold and is not, by definition, part of the drop.

Under the definitions of free play, gross revenue, bet, wager, drop, chip, and token, free play is simply never a part of the gross revenue count. Because free play does not make up a part of the drop, it cannot be a part of gross revenue or gross proceeds. Since free play is not included in gross revenue or

gross proceeds, deductibility is beside the point. This conclusion not only accords with the relevant statutory and regulatory definitions, it agrees with common sense and understanding – conceptually, free play cannot be income to the Gaming Establishments. It is given to potential patrons to attract them to the Gaming Establishments.

Free play is not a promotional award under ARSD 20:18:18:26 or 20:18:20.02:01

The Department's main argument is that free play is a promotional award under ARSD 20:18:18:26 and 20:18:20.02:01, and, consequently, cannot be deducted from gross revenue. However a closer review of the regulations demonstrates this interpretation is flawed. ARSD 20:18:18:26 and 20:18:20.02:01 must be read in the context of and together with the gross revenue calculation set out in ARSD 20:18:22:12. *See Moore v. Michelin Tire Co., Inc.*, 1999 S.D. 152, ¶ 16, 603 N.W.2d 513, 518-19 (when considering regulations together, the Court should interpret them to be "harmonious and workable").

> ARSD 20:18:22:12 states that gross revenue for a slot machine equals drop less fills to the machine jackpot payouts, hand pay credit lockups, and vouchers issued. Vouchers deducted from gross revenue that are not redeemed within 90 days of issuance shall be

> added back to gross revenue during the month the vouchers expired. The initial hopper load is not a fill and does not affect gross revenue. The difference between the initial hopper load and the total amount that is in the hopper at the end of each month must be adjusted accordingly as an addition to or subtraction from the gross revenue for that month.

In short, the point of the gross revenue calculation is to subtract the money paid out by the casino from the money paid in by its patrons. The deductions are merely a way of accounting for payouts – that is, the loss to the casino due to patrons' winnings. Indeed, ARSD 20:18:20.02:01 explicitly states that "*payouts* made pursuant to the promotion" may not be deducted from adjusted gross income. (emphasis added).

The fact that deductions, in this context, are synonymous with money paid out to patrons, rather than money taken in by the casino, is made clear by ARSD 20:18:22:12's treatment of vouchers. A slot machine voucher is a method of payout, defined as "a voucher for credits accumulated on a slot machine which is generated by a printer located internally in a slot machine. This voucher may be redeemed by insertion into an acceptance device on a slot machine." *See* ARSD 20:18:17:01(9). Obviously, if a voucher is redeemed, it

is money out of the gaming establishment's pocket. If, however, a voucher is not redeemed before its expiration date, the amount of the voucher is added back into the gross revenue. In other words, deductions from gross revenue are payouts that actually go to the patrons.

When it is recognized that deductions from gross revenue are for payouts to patrons, the purpose of ARSD 20:18:18:26 and 20:18:20:02:01 is clear. These regulations simply mean that casinos cannot treat promotional awards as part of the payout for purposes of calculating the gross revenue subject to gaming tax, even though these awards represent money going directly to patrons as a result of their gambling activities. The Department's position, however, is that free play should be treated like money coming *into* the Gaming Establishments, not like money going out to the patrons. As such, regulations relating to what outgoing cash flow may be deducted from gross revenue are inapposite.

The difference between free play and promotional awards is that free play gives a patron the right to play without paying, *see* ARSD 20:18:01:01; while promotional awards are something that a patron receives for playing, in addition to any winnings. The most that ARSD 20:18:18:26 and 20:18:20:02:01 have to say about free play is that, if it is awarded to a player as part of a promotion, it cannot be deducted *as an expense* of the casino. The

regulations do not dictate that free play must be included in gross revenue in the first place. The Gaming Establishments have not claimed they should be able to treat free play as an expense of gaming. Instead, free play is simply not part of their gaming income.

The Gaming Establishments have agreed that this proceeding is a declaratory action only, not a refund request

The Department devotes several pages of its brief to arguing that summary judgment was proper because the Gaming Establishments had not followed the proper procedure to seek a refund. This is a red herring. The Gaming Establishments conceded to the Circuit Court that they were not requesting a tax refund within the proceedings of this litigation, and this Court's prior cases clearly establish that a taxpayer may seek declaratory relief in such situations. *See Dan Nelson Automotive, Inc. v. Viken,* 2005 SD 109 ¶¶ 16-18, 706 N.W.2d 239, 245-46; *see also Tracfone Wireless, Inc. v. South Dakota Dep't of Revenue and Regulation*, 2010 S.D. 6, 778 N.W.2d 130 (ruling a taxpayer seeking refund of telecommunications gross receipts taxes could file an administrative appeal of the Department's denial of its refund claim and was not limited to relief through the payment-under-protest method).

Because the Gaming Establishments do not seek and have agreed they are not able to seek a refund within this action, the Department's arguments to

the contrary, including its claims of speculative harm to the taxing districts, are not relevant. As a practical matter, dismissing the case on this procedural ground would merely give rise to the potential for a multiplicity of actions. *See contra Metropolitan. Life Ins. Co. v. Kinsman*, 2009 S.D. 53, 768 N.W.2d 540 (where taxpayer was no longer paying taxes and time to file refund claims was long past, issue was moot). The Gaming Establishments continue to pay the gaming tax, including the disputed amounts, and they would have potential future refund claims and be able to cease paying such tax in the future in the event of a favorable ruling.

The fact that avenues for refund claims exist does not bar this action for declaratory relief. *See* SDCL §§ 21-24-1 (permitting declaration of parties' rights, status and other legal relations whether or not further relief is or could be claimed); 21-24-14 (declaratory judgment is "remedial; its purpose is to settle and to afford relief from uncertainty and insecurity with respect to rights, status, and other legal relations; and is to be liberally construed and administered"). The Court should reject this procedural attempt to sidestep the substantive issues before the Court.

The Gaming Commission's 2009 Refusal to Change the Rules Does Not Bar This Action

Finally, the Department would have this Court rule the present action is barred because the Deadwood Gaming Association filed a petition with the Gaming Commission in 2009 and/or because a separate party had a 2007 action before the Gaming Commission. As has been previously stated, no deference is due to the Department of Revenue's determination of whether a particular statute imposes a tax. *Paul Nelson Farm* at ¶ 7, 847 N.W.2d at 553-54. The 2009 and 2007 proceedings are not and cannot be controlling in the case at bar.

The prerequisites for such preclusion are not met. "Issue preclusion only bars a point that was *actually and directly in issue* in a former action and was judicially passed upon and determined by a domestic court of competent jurisdiction." *Nemec v. Goeman*, 2012 S.D. 14 ¶ 15, 810 N.W.2d 443, 446 (quotations omitted). First, the 2009 proceeding was a petition to amend the Commission's rules. This proceeding, however, is not a request for a rule change or an attack on the Commission's refusal to amend the rules; the issues in the two proceedings are different. Second, the 2007 proceeding involved separate, unrelated parties. The actions of administrative agencies are not extended *res judicata* effect when the agencies are not acting in a judicial capacity, resolving factual issues which the parties before it have had an

adequate opportunity to litigate. *See Gottschalk v. S.D. State Real Estate Comm'n*, 264 N.W.2d 905, 907 (S.D. 1978).

While the Gaming Establishments may be current members of the Deadwood Gaming Association, there is no record evidence of such, including any record evidence that they were members at the time of the 2009 petition for rule amendment before the Gaming Commission or whether they had any ability to or, in fact did, participate in that petition. Nor is there any evidence or claim they were related to the party who brought the 2007 matter before the Gaming Commission. Further, this *res judicata* argument was not asserted and developed prior to the hearing on this motion, but was simply raised by the Court at argument, without record evidence to support assumptions made. *See* HT at pp. 7-8. *Res judicata* effect should not be granted on such a limited record and without demonstration that the arguments presented here were actually and directly at issue before the Gaming Commission, with the Gaming Establishments acting as parties with a fair and adequate opportunity to litigate the issues.

Further, it has been recognized that "especially in the administrative setting, … 'res judicata is at its best in foreclosing a second determination of issues of fact,' rather than issues of law – as are presented here." *Interstate Telephone Co-op., Inc. v. Public Utilities Comm'n of State of S.D.*, 518 N.W.2d

749, 752 (S.D. 1994) (quoting 4 KENNETH CULP DAVIS, ADMINISTRATIVE LAW TREATISE § 21:2 at 49 (2d ed. 1983)). The issues presented here are questions of law, not questions of fact, namely – interpretation and application of statutes and regulations regarding whether free play can constitute income to the Gaming Establishments, such that they should be taxed on it. It is a misapplication of *res judicata* to insert it here.

The Gaming Commission is not a court of competent jurisdiction which issued a ruling upon the present arguments in a case where the Gaming Establishments were parties. When both the Department previously conceded the Gaming Commission's prior actions did not have *res judicata* effect, and the Circuit Court agreed with that concession, the Department should not now be permitted, for the first time on appeal, to assert that *res judicata* does, in fact, control the resolution of this case. *See Hall v. State ex rel. South Dakota Dept. of Transp.*, 2006 S.D. 24, ¶ 12, 712 N.W.2d 22, 26-27 (stating "[w]e have repeatedly stated that we will not address for the first time on appeal issues not raised below" and citing *Action Mech., Inc. v. Deadwood Historic Pres. Comm'n*, 2002 SD 121, ¶ 50, 652 N.W.2d 742, 755 ("An issue not raised at the trial court level cannot be raised for the first time on appeal."); *Sedlacek v. South Dakota Teener Baseball Program,* 437 N.W.2d 866, 868 (S.D.1989) (stating that where a party "failed to develop

the record" on an issue "we deem that issue abandoned");*Fortier v. City of Spearfish,* 433 N.W.2d 228, 231 (S.D. 1988) ("Since this issue was not framed in the pleading and was not addressed by the affidavits in support of or resistance to the motion for summary judgment, we do not believe the issue was properly before the trial court. Therefore, we will treat the issue as not being properly before us...."). To raise a legal argument on appeal in an answering brief without first addressing it below puts the adverse party at an extreme disadvantage. Had the issue been raised below, the parties would have had an opportunity to consider whether additional evidence was needed to decide the issue and certainly would have had an opportunity to brief the issue for the trial court's consideration. Likewise, the trial court would have been made aware of the issue and given an opportunity to rule on it. Moreover, since the argument was first raised by the State in its answering brief to this Court, the opposing parties' ability to respond was limited to its reply brief. For these reasons, we decline to review this particular argument proffered by the State. *Cf. Williams v. Maulis,* 2003 SD 138, ¶¶ 25-28, 672 N.W.2d 702, 707-08 (refusing to review an issue properly noticed for review by an appellee where the appellant failed to file a reply brief and therefore failed to address the issue and where "the trial court did not address the issue because it granted summary judgment on other grounds").

The Department's *res judicata* argument is merely an attempt to turn prior administrative actions involving different parties and different procedures into legal precedent controlling this Court. The Court should disregard this *res judicata* argument as untimely raised, unsupported by the record, and legally insufficient.

CONCLUSION

For the reasons stated above, the Gaming Establishments respectfully request the Court to reverse the Judgment in favor of the Department and to remand this action to Circuit Court, with the direction to enter Judgment in favor of the Gaming Establishments. Free play is not income to the Gaming Establishments, and they should not be required to pay dollar-for-dollar tax upon such a fiction.

Dated at Sioux Falls, South Dakota, this 7th day of August, 2014.

DAVENPORT, EVANS, HURWITZ & SMITH, L.L.P.

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