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Client Alert: Reform the Federal Sports Betting Excise Tax "Dilemma"

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Now that Congress has passed a budget resolution that sets the stage for fast-track tax reform, here is one tax that clearly should be included in any reform package:

> ***The excise tax on sports betting*** that is codified in sections 4401 and 4411 of the Internal Revenue Code. *See* 26 U.S.C. §§ 4401 and 4411.

The excise tax on sports betting contributes nothing to the national treasury and was never intended to do so. Rather, Congress included this excise tax in the Revenue Act of 1951 "to facilitate the enforcement of state criminal laws against gambling." Note, *The Federal Gambling Tax and the Constitution*, 43 J. of Crim. Law and Criminology 637, 637 (1953).

The Revenue Act of 1951 imposed a debilitating 10% excise tax on the total amount wagered on sporting events (i.e., a "handle tax" or "turnover tax") and a special $50.00 (Nevada)/$500.00 (unauthorized areas) per year occupational stamp tax and registration requirement on any person liable for the 10% excise tax. *Id.*

These provisions created two dilemmas for sports betting operators. The economics of the debilitating 10% tax rate on handle effectively preempted the launch of *bona fide* sports betting operations inside licensed and regulated casinos in Nevada, which issued its first gaming license in 1931. In addition, the stamp tax registration information—which the IRS openly and notoriously shared with criminal prosecutors—imposed a Catch-22 dilemma on sports betting operators in other states.

"If they register and provide the information required by the act, they may be subject to prosecution as violators of state anti-gambling laws," one author wrote. "On the other hand, if they refuse to register, the sanctions on the wagering statute become operative." *Id.*

In 1968, the Supreme Court found in companion cases that both payment of the excise tax and the stamp tax registration requirements were so unfair and onerous that they violated sports betting operators' constitutional right to be free from self-incrimination. *Grosso v. U.S.*, 390 U.S. 62 (1968) (payment of tax); *Marchetti v. U.S.*, 390 U.S. 39 (1968) (stamp tax registration requirements).

In 1974, Nevada Senator Howard Cannon succeeded in urging Congress to reduce the sports betting excise

tax from 10% of handle to two percent of handle. Immediately, sports books began to appear in Las Vegas casinos when Jackie Gaughan opened a sports book at the Union Plaza Hotel and Casino. In addition, in 1976, long-time Las Vegas sports and turf club odds-maker Jimmy "The Greek" Snyder joined and became a fixture on CBS' *NFL Today* pre-game show with Brent Musburger.

Subsequently, in 1984, Congress again reduced the tax rate for licensed Nevada sports betting operators to the current 0.25 percent of handle. (The tax rate remains two percent for unlicensed—i.e., black market—sports betting operators.) *See* 26 U.S.C. § 4401.

A 0.25 percent handle tax might not sound like much, but, when combined with the 6.75 percent state tax on gross gaming revenue (GGR) and approximately one percent licensing fees that Nevada sports betting operators pay, the federal sports betting excise tax increases the effective sports betting tax rate such operators pay to about 12% of GGR.

History demonstrates that Nevada operators can carry this 12% effective tax rate and effectively compete with unlicensed black market operators, but research also shows that when the effective tax rate on sports betting GGR reaches 15%, sports bettors begin to flee the licensed and regulated market for the unlicensed black market. The licensed and regulated sports betting market simply cannot function properly if it is carrying taxes that are not creating any benefits for the public.

And it is indisputable that the federal sports betting excise tax is of no benefit to the public. According to the Urban Institute & Brookings Institution's Tax Policy Center, in 2015, the IRS collected about $588 million in "other" excise taxes. Based on the $4.2 billion of sports bets Nevada operators handled in 2015, it can be calculated that the federal sports betting excise tax resulted in about $10.5 million in federal tax revenue. In comparison, the IRS collected total tax revenue of approximately $3.3 trillion in 2015. In other words, the sports betting excise tax contributes just .00000003 percent of federal tax receipts.

In the next six months, the Supreme Court will decide a case, *Christie v. NCAA*, which may lead to the expansion of full-scale sports betting in states beyond Nevada. If sports betting expansion comes to pass and the excise tax is not reformed, an unintended consequence of expansion will be a federal tax increase as more operators and more sports betting become subject to the tax.

In addition, a decision in favor of expanded sports betting will increase operational expenses for private sports organizations—NFL, NBA, MLB, NHL, NCAA, etc.—who will have to invest in enhanced integrity monitoring of increased sports betting. Congress should not stand idly by and passively subject sports organizations to such a negative economic externality.

Rather, Congress should reform the sports betting excise tax by enacting a dollar-for-dollar tax credit for every sports betting operator that agrees to pay a sports organization a percentage of the handle the operator generates from offering betting on the sports organization's games.

Such a sports betting tax credit will enable sports organizations to fund enhanced monitoring of sports betting and integrity without increasing the current cost sports betting operators incur to provide sports betting in Nevada.

This reform will maximize sports betting operators' ability to compete with unlicensed, black market operators while simultaneously maximizing the protection of the integrity of the sporting events from which the betting is derived.

In other words, a sports betting excise tax credit will create positive economic externalities that will

strengthen the expanded, licensed and regulated sports betting market for the benefit of the public, the sports betting operators, and the sports organizations.

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