

**ESTIMATE OF FEDERAL REVENUE EFFECT OF
PROPOSAL TO
REGULATE AND TAX ONLINE GAMBLING**

EXECUTIVE SUMMARY

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UC Group

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On April 26, 2007, Rep. Barney Frank (D-MA) introduced H.R. 2046, the "Internet Gambling Regulation and Enforcement Act of 2007," that provides for the licensing and regulation of lawful Internet gambling by the Director of the Financial Crimes Enforcement Network of the U.S. Department of the Treasury. On March 4, 2008, Rep. Jim McDermott (D-WA) introduced H.R. 5523, a companion bill to H.R. 2046, that would impose a fee on companies licensed to provide online gambling services in the United States.

PricewaterhouseCoopers LLP ("PwC") was retained by UC Group to estimate the federal revenue effect of the H.R. 2046 and H.R. 5523. UC Group is an online payment services provider that does not operate in the U.S. market. PwC has not taken any position in favor or against adoption of the legislative proposal, and has not been retained to provide any advocacy services in connection with the proposal.

The revenue analysis is based on available data, conversations with industry experts, and our professional judgment. The conclusions rely on projections of future events and behavioral responses that inherently are uncertain. The revenue analysis is intended to provide Congress with information that may be useful in the official scoring of the legislation's revenue effects.

The Frank bill (H.R. 2046) would create a regulatory and licensing regime for online gambling. The McDermott bill (H.R. 5523) would impose a two-percent licensing fee on deposits received by licensed operators and clarify the treatment of internet gambling under the tax code. The analysis in this report takes into account certain clarifications and modifications to the Frank bill, including the following:

1. Internet gambling licensees would be required to be incorporated in the United States, and senior management and computer equipment would be required to be located in the United States.
2. Congress would authorize states to impose indirect taxes on licensees with respect to wagers placed from within their jurisdictions, whether or not the licensee has nexus with the particular state.

The revenue analysis is based in part on projections by H2 Gambling Capital ("H2GC") of U.S. online gambling revenues under present law and under H.R. 2046, assuming no opt outs by states or sports leagues. H2GC is a consulting firm that tracks online and land-based gambling on a global basis. H2GC collects data from a variety of sources including filings of public companies, relationships with certain private companies, and monitoring of website traffic.

To estimate the size of the U.S. gambling market under H.R. 2046, PwC adjusted H2GC's forecast to take account of potential opt outs; in particular, sports leagues were assumed to opt out for the entire FY 2009-18 budget period, and two scenarios were considered regarding state opt outs. Under the *low* opt-out scenario, states were assumed *not* to opt out with respect to online games that currently are authorized in land-based form within their jurisdictions. Under the *high* opt-out scenario, it was further assumed that 10 states which prohibit online gambling would fully opt out regardless of the fact some forms of land-based gambling are authorized in these states (i.e., Illinois, Indiana, Louisiana, Michigan, Nevada, New Jersey, New York, Oregon, South Dakota, and Washington).

Under H.R. 2046 and H.R. 5523, licensed online gambling operators would be required to pay the existing federal wagering and corporate income taxes as well as a new licensing fee applicable to deposits. In addition, licensees would be subject to a separate and more comprehensive obligation to

provide information returns regarding winnings to the Internal Revenue Service and players. As under present law, players would be subject to individual income tax on net winnings.

Over the FY 2009-18 period, the federal revenue effect of H.R. 2046 and H.R. 5523 (including revenues from the wagering tax, licensing fee, and individual and corporate income taxes) is estimated to range from \$10.9 billion under the *high* state opt-out scenario to \$21.4 billion under the *low* state opt-out scenario (see Table E-1 below). In each case, about 56 percent of the revenue is attributable to individual income taxes, 22 percent is due to the wagering tax, 14 percent is due to the licensing fee, and 7 percent is due to the corporate income tax.

Table E-1. Revenue Effect of H.R. 2046 and H.R. 5523, FY 2009-18
(Fiscal years, millions of dollars)

Revenue source	2009	2010	2011	2012	2013	2009-13	2009-18
Low State Opt-Out Scenario							
<u>Total</u>	<u>\$0</u>	<u>\$1,069</u>	<u>\$1,465</u>	<u>\$1,844</u>	<u>\$2,182</u>	<u>\$6,559</u>	<u>\$21,407</u>
License Fee	0	149	206	262	311	927	3,069
Wagering Tax	0	229	309	393	470	1,401	4,647
Individual Income Tax	0	540	792	1,026	1,229	3,588	12,073
Corporate Income Tax	0	150	158	164	171	643	1,618
High State Opt-Out Scenario							
<u>Total</u>	<u>\$0</u>	<u>\$544</u>	<u>\$741</u>	<u>\$933</u>	<u>\$1,107</u>	<u>\$3,326</u>	<u>\$10,868</u>
License Fee	0	72	98	125	149	445	1,474
Wagering Tax	0	118	158	201	242	720	2,388
Individual Income Tax	0	279	406	526	632	1,842	6,204
Corporate Income Tax	0	75	78	81	85	319	803

Source: PricewaterhouseCoopers calculations. Effective date assumed to be October 1, 2009.

These estimates assume that all professional sports leagues in the United States opt out of the regulatory regime. If that were not the case, the bills would generate additional federal revenue. We estimate the legislation could increase federal revenues by as much as \$51.9 billion over the 2009 to 2018 period in the event that no sports leagues or states opted out of the regulatory regime (see Table E-2).

Table E-2. Total Increase in Revenues under Alternative Assumptions
(Fiscal years, millions of dollars)

Scenario	2010	2009-13	2009-18
<u>Sports Leagues Opt Out and:</u>			
High State Opt-Out Rate	\$544	\$3,326	\$10,868
Low State Opt-Out Rate	\$1,069	\$6,559	\$21,407
No State Opt Outs	\$1,988	\$12,264	\$39,963
<u>Sports Leagues Opt In and:</u>			
High State Opt-Out Rate	\$628	\$3,922	\$12,935
Low State Opt-Out Rate	\$1,279	\$8,048	\$26,568
No State Opt Outs	\$2,475	\$15,718	\$51,934

Source: PricewaterhouseCoopers calculations. Effective date assumed to be October 1, 2009.

PwC originally prepared a revenue estimate of the legislation in November 2007. This report contains revised estimates based on updated projections from H2GC of the U.S. online gambling market under current law and H.R. 2046. The revenue estimates in this report are approximately 22 percent larger than those in the November 2007 report. The increase in the estimate is attributable to the revised projections from H2GC, which were partially offset by other revisions.