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PAI 735
State and Local Government Finance
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Tax Revenue via iLottery and iGambling Policy Brief

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03 May 2015

Recommendation: The State should legalize online gambling and authorize the state lottery to operate online on the basis that online gambling would:

1. Provide revenue through a voluntary tax, which is preferred to raising income taxes, sales taxes, and property taxes.
2. Bring taxes from outside of the state and reduce the tax burden on in-state citizens.
3. Attract more affluent participants due to the accessibility and convenience and reduce the regressive tax due to gambling products being only used by lower income people.
4. Significantly lower the transaction costs of conducting business which directly raises revenues for the state.
5. Provide better protection to online gamblers and treatment for problem gamblers.
6. Enhance the oversight the state has on gambling giving them better regulatory controls and making it easier to enforce taxes on winnings.

Background of Online Gambling: One of the recent developments in the state of New York is the current debate on the legality and appropriateness of online lottery sales and other forms of online gambling hereafter referred to as iLottery and iGambling. Proponents of online gambling within the state point to the potential for new markets and different demographic groups to purchase lottery tickets and finance state requirements. Advocates also argue that online gambling permits the

state to leverage revenues from out of state and thereby reduce the needed tax burden on in-state citizens. Opponents point to decreased revenues for local vendors and the dangers of gambling addiction. The benefits of iGambling seem to outweigh the negative aspects as long as a few safeguards are put in place.

Provide revenue through a voluntary tax: One of the key issues that state governments are grappling with is how to finance the reasonable and necessary activities of the government. In the current era of state budget deficits and crumbling infrastructure, any source of revenue that can be termed “voluntary” is generally considered preferable to payroll or property taxes. Taxes generated by gambling are no exception to this preference. Given the “sinful” nature of gambling, and in particular lotteries, there is some political resistance to a state sanctioning gambling, but this resistance is relatively muted as 43 of the 50 states have a lottery of some form. As this is a voluntary tax, voters are more likely to approve of it as it potentially offsets income, sales and property taxes. The revenues from the states that currently have online gambling vary from state to state. New Jersey implemented their new online gambling in 2014 and was expected to have tax revenues of between \$160-180 million. (cooper, 2012) Online gambling is slow to get off its feet right now, but it is expected to grow dramatically as legislation and regulation come inline with its legalization. New Jersey is also a very small state compared to New York and estimates for New York could be much higher. This amount is relatively small compared to the current state budget (\$150B), but if used as targeted funding for services like education it could have dramatically positive effects on poor school districts.

Bring taxes from outside of the state: The potential market for international iGambling is very large. Statistics show that the global online gambling has grown from 7.4 billion in 2003 to 41.4 billion in 2015. Currently, the U.S. Offshore internet gambling market is 5.7 billion.(Statista, 2015) The U.S. online gambling market is relatively small compared with other countries and is probably due to the shaky ground that the courts stand on when it comes to online gambling. There are

currently only three states that have legalized online gambling, which are Nevada, New Jersey, and Delaware. The simple tax on rake transactions could amount to a significant amount of tax revenues for New York, where individuals outside of the state and even outside of the country will contribute much of it. The New York City “brand name” is world known as the financial capital of the world and by that alone comes with its own attractiveness to foreign gamblers. Another aspect to take into account is that as other states begin to legalize online gambling New York may lose some of its online gambling revenues to these states. Therefore New York should maintain some margin of comparative advantage in the long term by ensuring competitive rates of taxation and marginally higher winnings than other states via iGambling. The U.S. is well known as a safe haven for money and a secure environment because of vigorous law enforcement and a lack of graft and corruption. As such, foreign gamblers are more likely to feel safer sending their money to an online website that is based in and regulated by the state of New York, having a positive ancillary effect on participation and revenues.

Attract more affluent participants: One of the strongest arguments that proponents of iGambling make are that the current system of state gambling revenue generation is extremely regressive in nature. This is borne out in numerous studies that show that the preponderance of marketing of lottery products occurs in lower income neighborhoods and the typical consumer of the majority of gambling products is below the median income within any given state. While there is wide dispersal of web enabled smartphones and other means to access iGambling systems, access to the means of viewing iGambling systems is only one part of the equation. A fundamental part of any move to iGambling is to limit access to iGambling to those with access to a substantial credit limit or a prepaid card, something that lower income households typically do not have. This effectively limits participation in iGambling to a more affluent segment of society and thereby reduces some of the regressive nature of the current system.

Potentially lowers the transaction cost of conducting business: Paper tickets such as scratch-offs and jackpot lotteries have a small but not negligible cost per ticket. There is also other associated overhead such as dispensing machines, fees paid to retailers, and percentages of winnings paid to retailers. iGambling and online lotteries have associated costs that are mostly technology and administration based. This will effectively remove the associated fees paid to vendors and as technology advances decreased costs are possible. By reducing the marginal costs of operating the lottery system and making it more efficient, the marginal revenues per ticket or product sold can increase, thereby increasing state revenues.

Provide better protection to online gamblers: The legitimacy of gambling websites is a concern because these sites are offshored in countries that have legal gambling. Under the current system gamblers are not able to send currency to a website that is considering a gambling website. Financial institutions including all banks and internet pay services such as PayPal will not allow a transaction to go through if it is intended for the purpose of gambling. The alternative to this is to send an international money order to the websites office. This could be an unsecure transaction and could result in the player losing their money once it is received in foreign country. Other issues include websites not giving the players a fair advantage by manipulating the cards through computer programming or revealing an unsuspecting player's cards to other players. With the legalization of state gambling, the state would be able to serve as protection against these illegitimate websites and prosecute violators. The state would have jurisdiction to force websites to pay out gambling winnings. This would provide a safer environment for all involved and allow transactions to occur without uncertainty from the players or the websites.

There are websites that track online sites and report problems that have been reported by players. One of these sites is "The Wizard of Odds" that keeps a running list of reports of illegitimate sites and the problems they have. Most of the problems reported are related to false advertising of odds of winning, non-payment of legitimate winnings, not paying royalties on advertisements, and stolen website

content. Though anecdotal, some incidents are useful in highlighting problems that would be resolved by New York state regulation of iGambling. One incident refers to an online casino based in Curacao called Moore Games. Two players filed complaints that their account balances of €9,000 and €24,000 were zeroed out. The casino in turn denied that they had an account there. Another reported incident involved players playing nearly 1,000 hands of blackjack without a single winning hand. The statistical probability of this is 1:434,000... with another 150 zeros after that. (Online Casino Blacklist, 2015) The risks that players put themselves at when sending their money to a site that is regulated overseas would be alleviated by allowing sites to operate within New York state borders. A state seal of approval and access to the New York state legal system provides a protective hedge against scammers and wrong doers.

Increases the oversight the state has on potential revenue streams: The state can regulate online casinos operating in the state of New York, issuing licenses to websites that provide players with legitimate play and abide by existing laws regarding odds-making and gambling. Taxation will be enhanced via the state's increased oversight of products and participation. Websites typically charge a "rake" fee for providing the services and the state can impose a nominal tax on all rakes. Additionally, funds being paid to individual players can be better monitored by having the website report its payouts and issue appropriate taxation documents. Currently, gambling winnings are required to be reported to the IRS, but it is difficult to capture winnings by any individual because it is a self-reporting system. With online gambling, all winnings are easily tracked and the state can tax the winnings immediately. New York State is already ahead of the game when it comes to individuals working in New York but actually living in New Jersey for example. These workers are referred to as "Road Warriors" because they are earning their income in a state that they do not pay taxes in. These tax laws vary from state to state. Some states have the "first day" rule, where you owe income tax to that state on the first day that you earn income in that state. Other states set a minimum amount earned which ranges from \$300- \$1,800 in any given month. (Povich, 2013)

These tax laws can be modified or used as they are to account for earned income in the State of New York through gambling winnings. The state could also write legislation that requires individuals to give their social security number or other tax identification number. This will enable tracking by New York and the IRS of an individual's taxable winnings.

Primary arguments against legalization and mitigating factors:

It will encourage additional gambling by those with serious gambling addictions. This has not yet proven true in states that have allowed iGambling. A study conducted by Harvard Medical School of 40,000 people showed that most online gamblers play very moderately and with small amounts of money. (Finger, 2013) It is also easier to police online gambling than gambling done at a casino because users would have to login with personally identifiable information and the system could track individual's gambling habits should they become problematic. A gambler that has been identified as having a problem could be addressed by limiting the amount of money they are permitted to risk or even potentially blocking them from the site. Blocking is not without risks as an addicted user could be driven to use other channels of gambling, potentially placing them at the mercy of illegitimate sites not in the state of New York. The state will need to study the differences between existing systems to assist problem gamblers and the correct way to deal with potentially unique challenges of iGambling. We suggest that a specified percentage of iGambling revenues be set aside to deal with these issues much like current casino revenues are. In New York, the state and local governments already provide substantial assistance to those with gambling addictions and iGambling revenues would need to contribute to that end.

Loss of revenues by local vendors. Any cannibalization of sales will directly impact the profitability of local vendors. That aspect lends this argument some credence, but other states that have adopted iGambling have not realized a major shift away from sales at brick and mortar retailers. In fact, states that have partially

adopted iGambling and iLottery have seen their total revenues from gambling increase by up to 25% while associated drops in revenues via traditional vendors has been negligible. This would seem to at least partially indicate that iGambling has successfully reached an otherwise untapped demographic group. Stores argue that they will lose ancillary sales as a result of people not having to buy their lottery ticket from convenient store locations and these losses would lead to less tax revenues and in turn lead to a loss of jobs across the convenience store industry. They will also lose out on the commission of selling the winning lottery ticket and the commission fees associated with them, which is a good argument. However, other convenience stores are arguing that the lottery business does not make up the bulk of their business and results in about eight to ten percent of their sales and is not the reason that they are in business. Also, iLottery is not being removed from convenience store locations; it is just giving the customer another option to buy their tickets online. There may be a decrease in lottery ticket sales at convenience store locations and a decrease in ancillary sales, but these numbers could not be calculated unless a study was conducted, which could prove to be negligible and would be greatly outweighed by the additional tax revenues from iLotteries. (Thomas, 2012)

Interpretation of the Wire Wager Act of 1961, which made it illegal to conduct gambling over the use of an electronic wire method. This Act has is dated and the language has been misconstrued with the advancement of technology and the Internet. The specific wording in the Act is “Whoever being engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest, or for the transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined under this title or imprisoned not more than two years, or both.” (18 U.S. Code § 1084) In 1961 the only forms of electronic

communication was through telegram or a telephone. Therefore this Act was never intended to make it illegal to gamble over the Internet. Recently in 2011, the Office of Legal Counsel revised its view on the Wire Wager Act and specifically stated that non-sporting events were outside the scope of this Act. This is on the premise that the language in the act does not account for the gambling on non-sporting events so it does include lottery, poker, or slot machine activities. The original purpose of this Act was to target Bankrollers and Kingpins working on the mafia's behalf to prevent them from gambling on specifically sporting events and horse races. From the courts perspective, according to a Forbes article in 2011 the Department's Office of Legal Counsel (OLC) concluded in a brief that the Wire Wager act of 1961 only applied to sporting events and therefore, it does not apply to state lotteries.

Regressive nature of revenues from gambling by uniformed populations. An additional argument against the inclusion of iGambling and iLottery is that the majority of gambling revenues are generated from lower income and disadvantaged populations. The crux of this argument revolves around concerns about the morality of easing access to an entertainment source that many deem "sinful", or at least inadvisable. The counterpoint to this argument is that iGambling and iLottery have the inherent capability to eliminate many of the objections to gambling's disparate impact on specific populations. One objection is that certain populations are unaware of the incredibly low odds of winning. Online games could eliminate this by the state requiring that odds are conspicuously shown, thereby increasing the probability of consumers making choices that maximize their individual utility. A 2010 study found that "households with take home incomes of less than \$13,000 spent on average \$645 a year on lottery tickets, which is about 9 percent of their income" (Rosenfeld, 2013) This is the equivalent of volunteering an additional 5% tax through lotteries. For New York State to balance this tax on the poor they should provide incentives such as providing a tax incentive for playing the lottery to attract more affluent players. By attracting the wealthier population, the state could raise even more revenues and the wealth distribution would be more balanced.

Conclusion:

By allowing online gambling in the state of New York, there is the potential to raise additional tax revenues that could be used to help fund programs that need additional funding, such as education. This will be a new source of revenues for the state without the need to raise income or sales tax. This is a voluntary tax, which is the preferred method of taxation by state citizens. This will provide the opportunity to increase revenues from sources outside of the state that could alleviate the tax burden on in-state citizens. The costs to conduct a state lottery or a casino would be negated due to the very low transaction cost and very low overhead cost associated and would be transformed directly into tax revenues. The state would be able to provide protection to gamblers by providing regulations that these gambling websites need to abide by and also guarantee payouts of winnings. And finally, the state could better regulate income tax due to gambling winnings because of the more transparent nature of transactions over the Internet and their traceability.

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