PRICEWATERHOUSECOOPERS

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 June 7, 2007, Rep. Jim McDermott (D-WA) introduced H.R. 2607, 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 Alston & Bird, counsel to the UC Group, to estimate the federal revenue effect of the H.R. 2046 and H.R. 2607. 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. 2607) would impose a two-percent licensing fee on deposits received by licensed operators. The analysis in this report takes into account certain clarifications and modifications to the 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. The wagering and occupational taxes applicable to land-based gambling would apply to licensees.

3. The administrative rules applicable to the wagering tax would apply, mutatis mutandis, to the license fee, including penalties and interest for under payment, late payment, and failure to file.

4. Separate and more comprehensive income tax withholding and reporting rules would apply to proceeds arising from bets or wagers made with licensees.

5. 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 Global Betting and Gambling Consultants ("GBGC") of U.S. online gambling revenues under present law and under H.R. 2046, assuming no opt outs by states or sports leagues. GBGC is a UK consulting firm that tracks online and land-based gambling on a global basis. GBGC 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 GBGC's forecast to take account of potential opts outs; in particular, sports leagues were assumed to opt out for the entire FY

2008-17 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* state 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. 2607, 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. As modified, licensees would be subject to a separate and more comprehensive obligation to provide information returns regarding winnings to the IRS and players. As under present law, players would be subject to individual income tax on net winnings.

Over the FY 2008-17 period, the federal revenue effect of H.R. 2046 and H.R. 2607 (with assumed modifications and including revenues from the wagering tax, licensing fee, and individual and corporate income taxes) is estimated to range from $8.7 billion under the *high* state opt-out scenario to $17.6 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, 18 percent is due to the licensing fee, and 4 percent is due to the corporate income tax.

Table E-1. Revenue Effect of H.R. 2046 and H.R. 2607, FY 2008-17
(Fiscal years, millions of dollars)

Revenue source	2008	2009	2010	2011	2012	2008-12	2008-17
			Low State Opt-Out Scenario				
Total	$562	$951	$1,229	$1,597	$1,932	$6,272	$17,624
License Fee	103	178	237	293	353	1,163	3,242
Wagering Tax	124	213	278	347	417	1,378	3,828
Individual Income Tax	292	501	653	888	1,089	3,423	9,827
Corporate Income Tax	43	60	62	69	74	307	728
			High State Opt-Out Scenario				
Total	$279	$473	$606	$791	$956	$3,105	$8,716
License Fee	47	82	108	134	161	532	1,483
Wagering Tax	63	108	139	175	209	694	1,924
Individual Income Tax	147	253	328	447	548	1,723	4,940
Corporate Income Tax	22	30	31	35	37	156	370

Source: PricewaterhouseCoopers calculations.

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 $42.8 billion over the 2008 to 2017 period in the event that no sports leagues or states opted out of the regulatory regime.

Table E-2. Revenue Effect of H.R. 2046 and H.R. 2607: Impact of Sports Leagues Opt Outs
(Fiscal years, millions of dollars)

Opt-Out Scenario	2008	2008-12	2008-17
Sports Leagues Opt Out and:			
High State Opt-Out Rate	$279	$3,105	$8,716
Low State Opt-Out Rate	$562	$6,272	$17,624
No State Opt Outs	$1,075	$12,074	$33,972
Sports Leagues Opt In and:			
High State Opt-Out Rate	$328	$3,646	$10,245
Low State Opt-Out Rate	$682	$7,623	$21,440
No State Opt Outs	$1,355	$15,208	$42,822

Source: PricewaterhouseCoopers calculations.