

**Internet Poker
Industry and Revenue Analysis**

Final Report

**Prepared by
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**For the
Poker Players Alliance**

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INTRODUCTION

Currently in the US, Internet gaming operates outside of our economic and revenue systems. Despite this fact, it enjoys widespread popularity in the US and has grown into a substantial industry. Within this industry, Internet poker is currently responsible for the significant growth rates in the Internet gaming. It appears that this growth will continue to dominate the industry and Internet poker will continue as the underlying force behind Internet gaming.

As an example of this growth, in 2004, the World Series of Poker hosted approximately 1,000 entrants all buying in for \$10,000 each. By 2005, there were 5,519 players buying in at \$10,000 each. Estimates suggest that 2006 will have 7,500 or more entrants.¹ Many of these players are winning their buy-in to the tournament through satellite online tournaments.

Currently, there is no Federal legislation specifically addressing Internet poker, and there is no legislation governing interstate gambling. US law remains ambiguous about Internet gaming. As a consequence, this uncertainty has pushed online gaming businesses to establish domicile outside the US borders.

This presents an interesting dilemma. On one hand, online gaming businesses are effectively discouraged from operating in the US. Yet on the other hand, the online gaming industry continues to grow at significant rates, fueled in a large part by US activity. Estimates indicate that amounts wagered through online poker sites were nearly \$60 billion (worldwide) in 2005 with nearly \$3 billion in commission revenues.²

The debate is underway about whether or not the US should pass legislation to establish online gambling as a viable US business activity and collect the tax revenues associated with that activity. There is unanimity about the need to clarify US laws as they relate to Internet gaming and specifically, Internet poker. However, there have been two distinct approaches to resolving the ambiguous position of this industry – one approach is to incorporate Internet gaming into our tax and legal systems and the other approach would exclude Internet gaming from our tax and legal systems.

Experience suggests that the latter approach would not be effective or in the best interest of the millions of US participants. Currently, we observe a significant industry that continues to grow and expand, supported in large part by the US activity, despite the uncertain status of Internet gaming. Given the well-established activity that currently exists, it is likely that the latter approach will simply cause a proliferation of smaller sites with many undesirable characteristics.

The focus of this study is to consider the effects of the former approach – one that would incorporate Internet gaming, specifically Internet poker, into our legal and revenue systems. The study focuses on the sources of potential revenue that would result from doing so and considers various options for developing a viable US Internet poker industry.

¹ Interview with WSOP Tournament Director Robert Daily, Pokerpages.com

² The vast majority of this activity is attributable to US activity.

I. EXECUTIVE SUMMARY

Internet gaming, and more specifically Internet poker, has become a dominant US pastime. Estimates indicate that, worldwide, amounts wagered in online poker games were nearly \$60 billion in 2005 with approximately \$3 billion in commission revenues. Further, industry estimates indicate that nearly 90 percent of these wagers are made by American players.³ Despite this surge in popularity, US laws do not reflect the market reality of this high growth industry.

While much of the policy debate addresses all forms of Internet gaming, the focus of this study is Internet poker. Internet poker has unique characteristics that distinguish it from other forms of gaming. As a result, there are grounds for developing a political and legislative strategy that addresses solely Internet poker.

Considering the characteristics and the magnitude of the Internet poker industry, the Federal government would collect a significant potential source of revenue after incorporating this industry into our economy. ***Conservative estimates of Federal revenues based upon the existing Internet poker market, if regulated and taxed, would generate potentially over \$3.3 billion annually in new taxes.***⁴

Three potential sources of revenue would accrue to the Federal government if appropriate legislative action is taken. Specifically, tax revenues from individual income taxes, user fees and corporation income taxes, are potential sources of revenue. Conservative estimates suggest that individual income taxes alone would ***increase Federal revenues by approximately \$2.5 billion each year.*** Additionally, if a one percent user fee, similar to the user fees commonly charged to land-based poker establishments, were to be applied to all transactions, this ***would generate approximately \$800 million to \$1 billion in revenue per year.***

Finally, to the extent that casinos and legal card rooms based in the US would enter the Internet poker market or that off-shore companies would relocate to the US, income taxes on corporate profits alone ***would result in approximately \$350 million in additional tax revenue, in addition to the \$3.3 billion mentioned above.***

In addition to Federal revenues, it is likely that numerous second order benefits would accrue if the US government regulates and taxes the existing Internet poker market. Specifically, most state income tax systems determine state tax liabilities based on the Federal tax base. As the Federal base increases, it is likely that ***state revenues would increase collectively by approximately \$1 billion.***

The reality of online poker is that it is here to stay. In addition to the 23 million online poker players, television broadcast of poker tournaments provides another indicator of

³ Estimates vary, but most sources suggest that Americans comprise between 75 and 90 percent of the world market for Internet poker. See PartyPoker industry analysis as well as MECN, Online Poker.

⁴ The potential exists for revenues to increase overtime, as projected growth rates in the Internet poker market are 15 to 20 percent per year. Further, the impact of US based Internet poker companies entering the market would further increase the overall growth rates.

the popularity of poker in the US.⁵ The presence of poker on US television stations continues to grow and attract larger audiences.⁶ Whether the Federal government approves or does not approve of Internet poker, it is clearly a dominant pastime and one that is likely to persist for many years to come. It is important to note that the Federal government, by taking a position opposing all Internet gaming, including Internet poker, has denied itself an important source of potential revenues and the ability to regulate and oversee this industry.

In summary, incorporating the Internet poker industry into our tax and regulatory system would provide significant benefits to both the US government as well as to individual citizens.

⁵ The Oklahoma Association for Gambling Addiction and Awareness reported that ComScore Media Metrix, which measures all US Internet users at home, work and college locations, believes that gambling websites had more than 29.1 million unique visitors.

⁶ For instance, the most popular poker television shows include: the World Series of Poker (ESPN), Celebrity Poker (Bravo), Superstars of Poker (Fox Sports), and the World Poker Tour (Travel Channel).

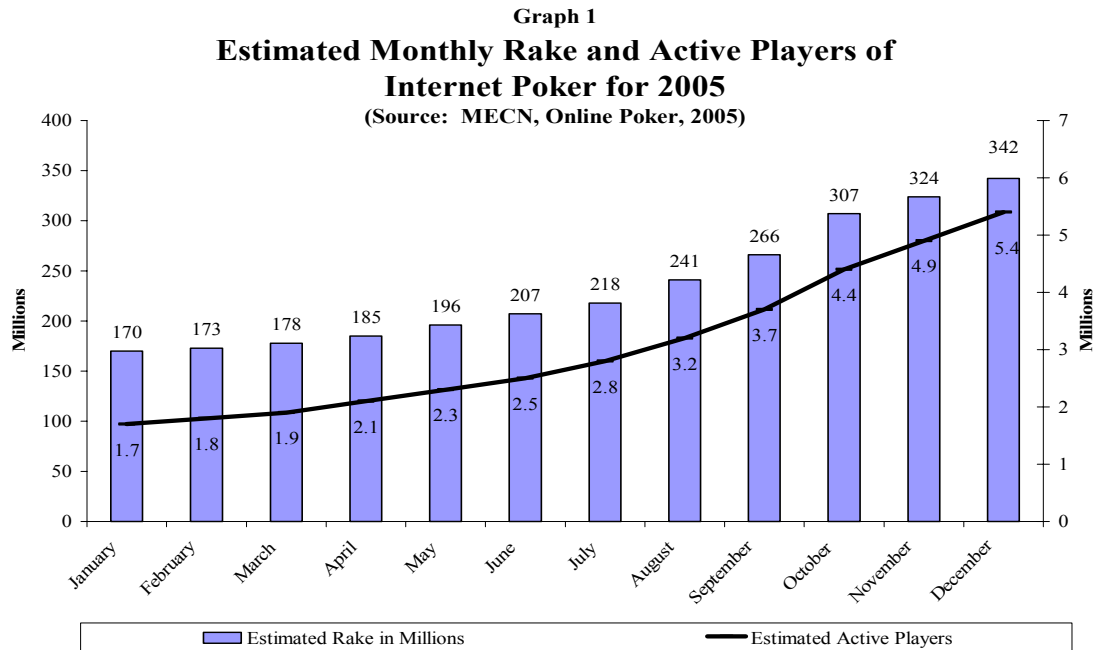
II. INDUSTRY ANALYSIS AND POTENTIAL SOURCES OF REVENUE

A. The Internet Poker Industry

Most industry experts believe that Internet poker is the force behind the growth in Internet gambling. The most recent estimates indicate that \$60 billion was wagered on Internet poker sites with roughly \$3 billion in associated revenues.⁷

The dominant trends in the Internet poker industry include rapid growth rates in existing markets, expansion to new markets, and rapid growth in amounts wagered. Currently, projected growth rates in the US market are expected to be 15 to 20 percent by the year 2008. Analysts believe that similar growth rates will emerge in new markets. Approximately 50 percent of industry analysts surveyed believe that Europe will have the greatest potential for expanding the online poker market. However, expansion is not limited to European markets, as Scandinavia and the UK, as well as Southeast Asian countries, are also likely to demonstrate significant growth rates in online poker. Within the US, industry analysts expect that land-based casinos will enter this industry, should the Congress pass legislation clarifying the status of Internet gaming.

It is important to emphasize that the strong growth in Internet poker builds on an already sizeable base—approximately \$60 billion in wagers in 2005. When considering double digit growth rates on a base of this magnitude, it is clear that this nascent industry has the potential to dominate most forms of Internet gaming.



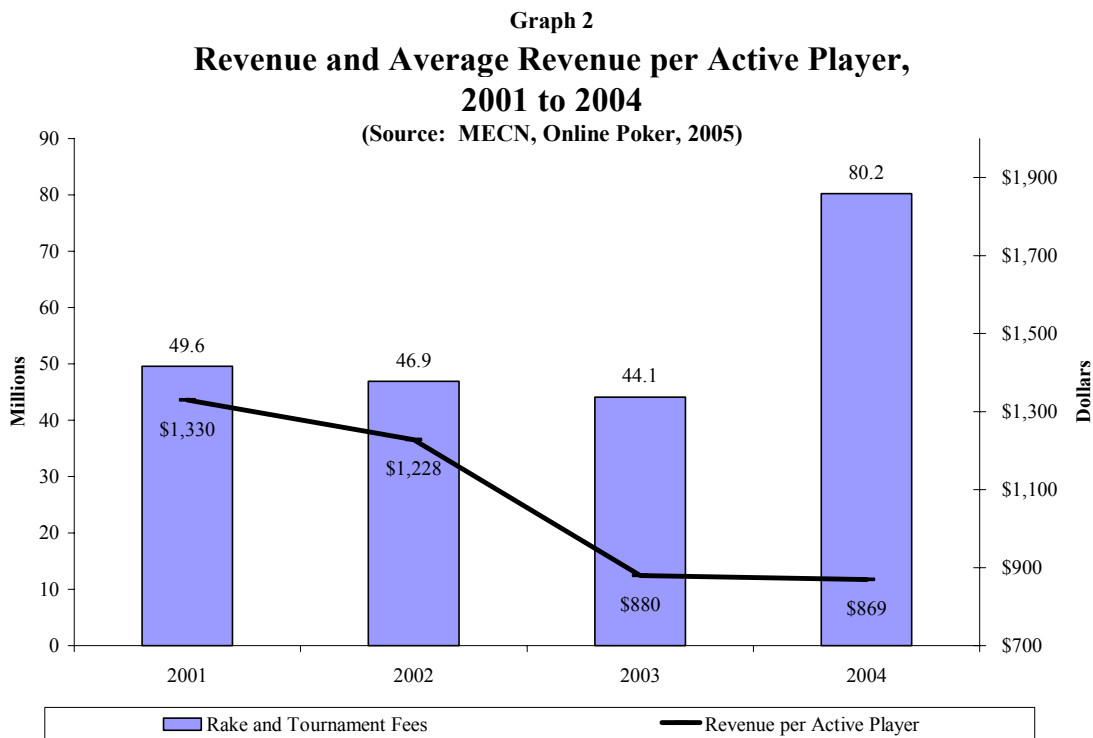
⁷ Note that the US Congress enacted the “Indian Gaming Regulatory Act in 1988,” and growth in Indian gaming facilities has been significant, generating \$22.7 billion in gaming revenue in 2005. For additional statistics on Indian gaming, see “Indian Gaming Industry Report,” by Alan Meister, Casino City Press.

Graph 1 presents the estimated monthly rake and number of active players for 2005. It is important to note that estimates indicate US players represent from 75 to 90 percent of the total players of Internet poker. This suggests that in December of 2005 alone, approximately 4 to 5 million Internet poker players were US players.

In addition to the rapid growth, there is another important trend emerging in online poker – the increased number of players making smaller wagers. In other words, the market expansion includes many new or novice players. The market is not specializing exclusively in experienced poker players, but rather is attracting a wide and diverse audience.

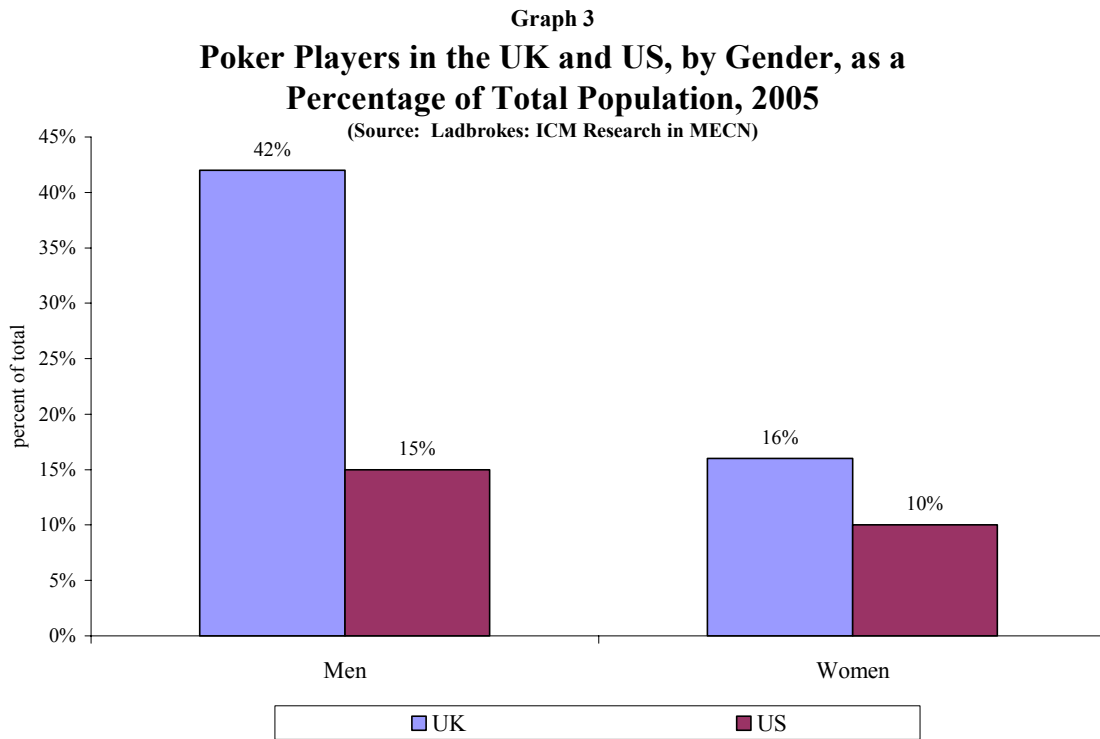
Graph 2 demonstrates the trend among active players, showing that average revenue per player is falling over time, despite the overall increase in the number of players. As mentioned, the likely explanation of this is the mainstream popularity of poker, witnessed by the strong television coverage.

While all forms of poker are quite popular, including stud poker, draw poker and community poker, one form appears to dominate all others: Texas Hold'em. This popular game attracts players from all walks of life.



Changing Demographics – The popularity of poker in the US is supported by the changing demographics. At one time, the traditional image of a poker player *was* a

younger, white male.⁸ However, that image is changing to include both men and women, across all age cohorts, as well as people of color. Currently, Ladbrokes (famous London bookmaker) estimates that poker players in the US are fairly evenly distributed among men and women as a percent of the total population. Graph 3 compares the distribution of poker players in the UK and US. As shown below, popularity among women relative to men is comparable in the US. However, this is not the case in the UK, where men are still the dominant poker player.



Poker Players are Affluent – An important characteristic of online poker players is their ability to afford the pastime. In general, individuals playing lotteries or other games of chance are typically lower income individuals. However, poker players are more affluent. A recent survey of 552 Internet gamblers, conducted by Peter D. Hart Research Associates Inc., showed 41 percent had incomes of more than \$75,000 a year, while only 12 percent had incomes of less than \$35,000.⁹

This is consistent with tax data reported for returns with gambling winnings. However, tax return data provides a profile of gamblers having a higher income level than those reported in the survey. While this is not specific to Internet poker, it is representative of likely poker players. Graph 4 shows that nearly 63 percent of those returns reporting gambling earnings had adjusted gross incomes in excess of \$100,000.¹⁰ Seventy-five

⁸ Such other forms of gambling as Lotteries have a very different demographic profile. Specifically, lotteries tend to attract lower income individuals, older individuals, and people of color (African-American and Hispanic).

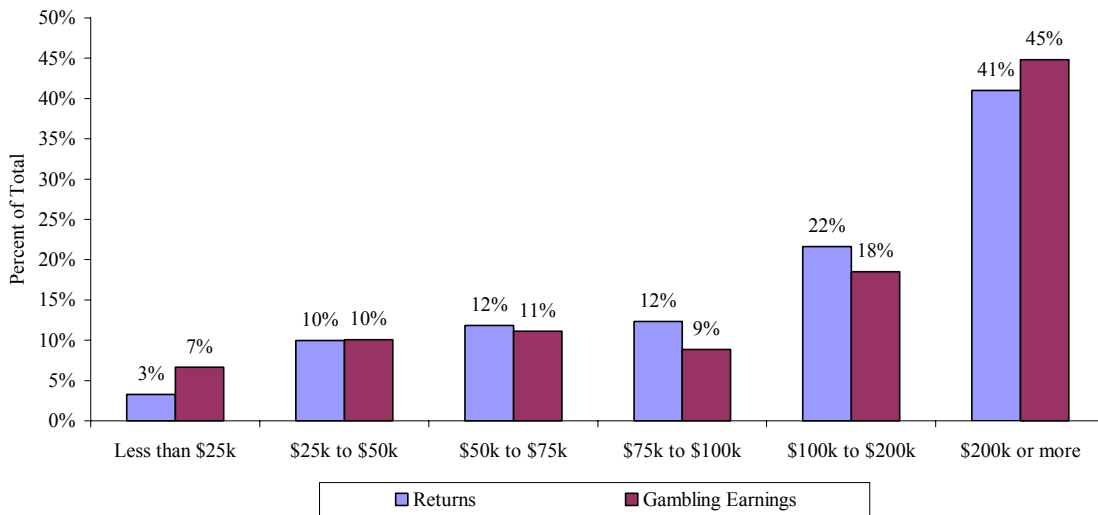
⁹ Further, approximately 61 percent had at least a college degree.

¹⁰ It is likely that these numbers provided a somewhat distorted picture because compliance levels with the rules requiring the inclusion of gambling winnings on tax returns are likely to be higher as income from gambling goes

percent of returns reporting gambling earnings had adjusted gross incomes in excess of \$75,000.

Further, these returns had nearly comparable shares of the total gambling earnings. Graph 4 shows that those returns with incomes in excess of \$100,000 had approximately 63 percent of total gambling earnings. Seventy-three percent of total gambling earnings were reported by those returns with incomes in excess of \$75,000.

Graph 4
Distribution of Gambling Earnings, by
Selected Income Class
 (Source: IRS, SOI Public Use Files,
 Individual Income Tax, 2003)



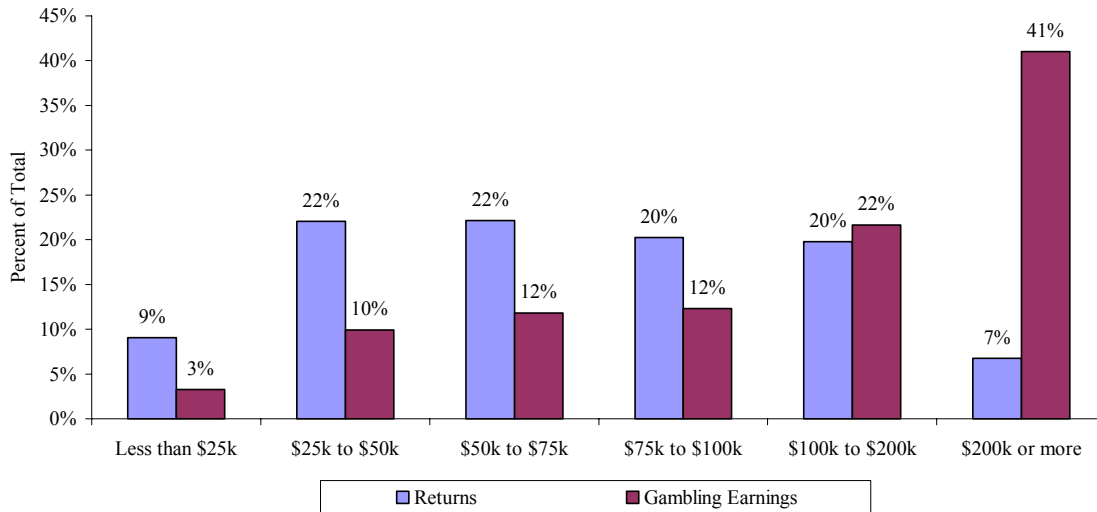
According to the IRS data shown in Graph 5, the distribution of returns reporting gambling losses is distributed more toward the lower end of the distribution with 73 percent having adjusted gross incomes less than \$100,000. However, the distribution of gambling losses (dollar amounts) is distributed more heavily toward the higher end of the income distribution with 63 percent of the losses attributable to taxpayers with adjusted gross incomes above \$100,000.

Under present law, limitations exist on the ability to claim gambling losses, so generally taxpayers will report net positive income. The limitation on reporting losses means that gambling earnings are likely to be subject to a higher marginal tax rate as shown in the distribution displayed in Graphs 4 and 5.

up. Thus, it is likely that lower income taxpayers with lower gambling winnings are less likely to report their winnings on their tax returns.

Graph 5
Distribution of Gambling Losses, by
Selected Income Class

(Source: IRS, SOI Public Use Files,
Individual Income Tax, 2003)



B. Revenue Analysis

The potential revenue associated with Internet poker would arise from three sources: individual income taxes, user fees or gross revenue taxes, and corporation income taxes. Conservative estimates of Federal revenues based upon the existing Internet poker market, if regulated and taxed, would generate potentially over \$3.3 billion annually in new taxes.¹¹ Currently, Internet gaming is available only through foreign owned firms that locate in other domiciles. Consequently, the vast sources of potential revenue remain largely outside the US tax system.¹²

Individuals – Revenue associated with individuals would include taxes paid on gambling winnings. By extending reporting requirements and withholding requirements, this is likely to present a significant increase in Federal revenues. This is the largest source of revenue as gambling earnings, in general, are likely to face serious underreporting problems.

¹¹ The potential exists for revenues to increase overtime, as projected growth rates in the Internet poker market are 15 to 20 percent per year. Further, the impact of US based Internet poker companies entering the market would further increase the overall growth rates.

¹² Under present law, individuals must report as income all revenue associated with gambling, regardless of the source. However, reporting and withholding requirements do not apply to Internet gaming and it is believed that this revenue remains outside the US tax system.

User Fees or Gross Revenue Fees – In addition to making individual and corporation income from Internet gaming subject to income taxes, the Federal government might also collect revenue from a fee that applies to the gross activities attributable to US citizens that participate in Internet gaming.

There are a variety of methods available to tax revenues as well as multiple ways to define the base to which the tax might apply. With respect to the base, the tax might apply to either gross revenues (gross revenues before any allowable deductions) or gross profits (gross revenue less certain allowable deductions). Alternatively, the user fee might apply to the individual transactions as they pass through the financial intermediary (e.g. credit card companies or such services as PayPal). In this case, the amount that is passed to the Internet poker site from a payment service would be subject to the fee.

In general, there is an inverse relationship between the user fee tax rate and the base. As the base increases, the rate necessary to raise a certain amount of revenue decreases. For example, if a firm has \$500 million in gross revenues, applying a 1 percent user fee would raise \$5 million in tax revenue. However, if the same firm reports \$100 million in gross profits, the rate must increase to 5 percent in order to raise the same amount of revenue.

Compared to making Internet poker businesses part of the regular business income tax system, the flat percentage tax would provide some certainty with respect to the revenue component. Britain has already made all forms of gambling legal and currently imposes a 15 percent tax on gross profits, collecting about \$2.4 billion over the past two years. This tax is imposed on total revenues less certain allowable deductions, a smaller tax base compared to gross revenues.

Alternatively, the State of Iowa imposes a gaming tax on gross gaming revenues. They employ a graduated tax rate structure that increases with gross revenues. Iowa's casinos pay to the State of Iowa a 5 percent gaming tax on the first \$1 million of gross gaming revenue, 10 percent on the next \$2 million and 20 percent on gross gaming revenues over \$3 million.¹³ This graduated rate structure raised approximately \$200 million in revenue for the State. It is important to note that Iowa represents one of the highest state tax burdens imposed on gaming, raising a significant portion of its state revenue from this source.

The following sections provide evidence of the magnitude of the potential revenue associated with simply clarifying the status of Internet poker and recognizing it as part of the US economy. The estimates are somewhat conservative for two reasons. First, it is difficult to estimate tax revenues without formal legislative language. Often the legislative language and the specific details will determine the magnitude of the revenue raising potential. Second, rather than making only the most favorable assumptions for this industry, the analysis takes a conservative posture. However,

¹³ In addition to these taxes, the casinos pay additional taxes and fees to Not-For-Profit License holders and city governments. The casinos also fund their regulatory (Iowa Racing and Gaming Commission) and enforcement (Department of Criminal Investigation) costs.

despite this conservative posture, it is important to recognize that the revenue potential is still quite significant and one worthy of serious legislative consideration.

Corporations – Revenue associated with corporations would result from those Internet gaming businesses that locate in the US. As other US corporations do, they would pay income taxes on the net revenues associated with their business activity. Most industry analysts anticipate that such land-based casinos as Harrah’s, MGM, or Trump would quickly enter the market if the status of Internet gaming were clarified. The most recent statistics available from the Bureau of Economic Analysis indicate that the net revenues associated with casinos (non-hotel revenue) were more than \$20 billion in 2002.¹⁴

Individual Income Taxes

With respect to individuals, there are two sources of positive revenue streams. One source is from capturing the unreported income associated with Internet poker. Theoretically, this income should be reported on an individual tax return. However in practice, it is likely that low rates of compliance abound. In other words, in the absence of information reporting and income tax withholding, it is unlikely that individuals will report Internet gambling winnings as income (particularly since the legal status of Internet gambling is, at best, ambiguous).

The other source of revenue is from income tax withholding that would result from identifying this source of income and making it subject to the regular requirements associated with other forms of income. For Internet poker, it is likely that the distribution of amounts earned will represent a large range. Consequently, to maximize the revenue associated with that range of poker earnings, the ***threshold for income withholding of gambling winnings would decrease to \$1,000.***

Note that requiring income withholding on Internet poker winnings in excess of \$1,000 would have a related effect impacting all other sources of gambling revenue as well as Internet poker revenue. Under present law, income withholding is required on amounts in excess of \$5,000. Given the low numbers of taxpayers reporting gambling earnings (1.5 million) and gambling losses (about 800,000), it is clear that significant underreporting occurs with respect to this source of income.

Based on the current US participation in Internet poker (for purposes of the estimate, it is assumed that 75 percent of the market is US-based), and the estimated growth in the demand for Internet poker, it is likely that revenues from individual income taxes would ***increase by approximately \$2.5 billion each year.***

About the estimate – In order to estimate the impact of collecting revenue from Internet poker, certain assumptions become necessary. First, for purposes of this estimate, it is

¹⁴ See US Department of Commerce, Census Bureau, Amusement, Gambling, and Recreation Industries: 2002, August 2004, EC02-711-03.

assumed that a considerable portion of the current Internet poker activity would be subject to information reporting and income withholding. Second, it is assumed that the distribution of Internet poker players is similar to that of individual taxpayers that report currently their gambling winnings.

With respect to gambling winnings, the estimate considers the net effect of poker winnings and losses. This assumes that the pattern for Internet poker would follow that of other forms of gaming currently reported on individual income tax returns. More specifically, Internet poker involves a level of skill (see the following section) not associated with other games of chance. Consequently, it is assumed that not all taxpayers will have net income. Those taxpayers with only losses will be unable to claim those losses (unless they are professionals and gaming is their primary source of income).

In order to apply a corresponding tax rate to those taxpayers subject to tax on their gambling income (and limited deduction on their losses), the distribution for all gambling is applied to the percentage of taxpayers assumed to participate in Internet poker.

In addition, this estimate assumes that the US Congress would act to make both the practice legal as well as to lower the amounts to which income withholding on all gambling would apply.

In summary, the important factors that influence the magnitude of this estimate include:

- An increase in unreported (net) gambling income of approximately \$9 billion each year
- An average marginal effective tax rate of 27 percent

User Fees or Gross Revenue Fees

As discussed, an alternative approach might impose a flat percentage tax on amounts wagered that originate in the US, but result in another jurisdiction. This tax or fee might simply apply a low tax rate (e.g. 1 percent of amounts wagered, not unlike the rake) to the Internet poker business. For instance, if projected revenues for Internet poker are expected to reach \$4 or \$5 billion by the end of 2006, then the amounts wagered are approximately \$80 to \$100 billion. If these amounts were subject to US tax of even one percent, this ***would generate approximately \$800 million to \$1 billion in revenue per year.***

About the estimate – This estimate assumes that a structure would be in place to require that financial intermediaries would collect the user fee from individual Internet poker players and remit the user fee to the Federal government. Currently, such a structure exists as all financial activity associated with Internet poker occurs electronically. Therefore, the Congress would need to pass legislation creating such a tax and require that all US businesses handling the financial transactions comply.

Business Taxes

The estimate for US Federal taxes on US Internet poker businesses is less clear, as the incentives to locate in the US are less clear if legal status is granted to Internet poker. As the world market grows, the US gambling industry (land-based casinos) will want to gain a stake in this growth industry.

Further, if US sites are held to US laws and regulatory guidelines with regular oversight, US citizens might gain a comfort level with these businesses as opposed to those sites operated abroad. It is important to note that when an activity is currently prohibited or whose legal status is ambiguous, it is likely that a significant increase in that activity will occur after the appropriate legislative action is taken.

However, from the business' view, Internet poker businesses may feel that from a tax perspective, they are at a disadvantage by establishing domicile in the US. This has been the case for many businesses and a trend in establishing offshore headquarters has become more and more pronounced. In addition to the tax benefits, many businesses feel that the regulatory environment, wage structure, and legal systems might favor establishing domicile in another country.

About the estimate – One simple approach to estimating the tax revenue from Internet poker that might arise from US land-based casinos (e.g., Harrah's, MGM, or Trump) establishing their own sites is to assume that revenues from Internet poker would be a fraction of their current revenues. Using data from the Census Department, if we assume conservatively that Internet poker would represent 5 percent in additional revenues to land-based casinos (of \$20 billion in current net revenues) we would assume that approximately \$1 billion in net receipts would be subject to the corporate income tax. Assuming a 35 percent tax rate, ***this would result in approximately \$350 million in additional tax revenue.***¹⁵

Second Order Effects

It is worthwhile to note that while second order effects do not influence the estimated revenue effects for Federal tax purposes, they do affect local economies by stimulating other economic activity. For instance, all gaming activities currently generate revenue in related industries. However, by integrating Internet poker into the US economy, one might expect a considerable increase in related economic activities. One example is in the advertising industry. Internet gaming websites are expected to spend considerable sums on television and print media ads. Some estimates suggest that individual firms are expected to spend \$5 to \$10 million per year on advertising in the US alone.

¹⁵ The magnitude of this number depends heavily on the assumption that land-based casinos would enter this market as industry studies indicate. It further assumes that these companies would establish domicile in the US and be subject to the tax laws and regulatory framework of the US government.

Further, other benefits to the local economies include the creation of new jobs for those businesses that establish in the US. It is also expected that these businesses would be subject to state taxes as well as regulatory and licensing fees. Further, most states income tax systems determine state tax liabilities based on the Federal tax base. As the Federal base increases, it is likely that ***state revenues would increase collectively by approximately \$1 billion.*** As a result, the impact of clarifying the status of Internet poker is likely to have positive economic ramifications throughout the US economy.

III. DEVELOPING A FRAMEWORK FOR LEGISLATION TO ALLOW INTERNET POKER

A. Why Poker is Different from Other Online Gaming

There are several features of online poker that distinguish it from other forms of Internet gambling. These features create a natural starting point for regulatory and legislative efforts, as the nature of the game itself provides a relative degree of transparency compared to other casino-style Internet gambling.

Background – Poker began over 400 years ago with similar games. The name poker is derived from the German game, Pochen (show off). This German game, with minor modifications, evolved into a French game, Poqué. In the mid-1800s the game was brought to the US, making its way north through the US on riverboats. The game made its way to California during the gold rush, and poker became well-established and is now considered an American game.

Online poker has become a uniquely American pastime. The growth in Internet use and the availability of online services allows the US market to lead this phenomenon. While poker and online poker currently are US activities, both forms of poker are spreading quickly to European countries. Evidence of poker's popularity abroad is in the European Poker Tour that will have events in Barcelona, London, Paris, Vienna, and Dublin.

More than 60 percent of industry experts in a survey by Media and Entertainment Consulting Network (MECN) believe that online poker will be the dominant offer in online gaming within two to three years. For this reason alone, regulatory and legislative efforts should focus their attention on Internet poker as it has already eclipsed other forms of online gambling.

About the Game – One feature that distinguishes poker from other casino-style games is that the latter are primarily games of chance. In contrast, poker involves skill as the player must make crucial decisions as part of the game. This skill involves knowledge of probability and odds of winning certain card configurations.¹⁶ Such casino-style Internet games as slot machines involve merely the random generation of a number to determine a winning combination. The player has no input or decisions during the stages of the game, as are required in poker.

Another important distinguishing feature of online poker is that the source of revenue for the game comes from either tournament fees or the 'rake.' Tournament fees are a

¹⁶ From Cabot and Hannum, "When analyzed in light of constitutional and statutory lottery prohibitions that prohibit games of chance, court opinions and attorney general opinions have frequently found poker to be of sufficient skill as not to be a lottery game." (See their references to *Harris v. Mo. Gaming Commission*, 869 S.W.2d 58, 64 (Mo. 1994); *Bell Gardens Bicycle Club v. Dep't of Justice*, 36 Cal. App. 4th 717, 743 (2nd Dist. 1995); *Op. Colorado Attorney General*, 9 (Apr. 21, 1993); *State v. Coats*, 74 P.2d 1102, 1106 (Or. 1938); see also *Ginsberg v. Centennial Turf Club, Inc.*, 251 P.2d 926, 929 (Colo. 1952).)

fixed amount that players must pay before entering the tournament. Typically, these are onetime fees, unrelated to the size of the pot or the number of players.

Alternatively, the ‘rake’ is the fee associated with each game. It is related to both the number of players and pot size (total amounts wagered). In most cases the rake charged by online poker sites ranges from 3 to 5 percent.

Internet poker sites make available the rake structure, as all sites makes money through collecting a set percentage of the total pot at the end of every hand. It is important to note that most sites do not collect money on hands that do not reach a certain stage – the flop, also referred to as a ‘No Flop, No Drop policy.’¹⁷

An example of a rake structure is shown in the following tables. These tables reflect the rake structure of InterPoker, an Internet poker site. Table 2 shows the rake for games by the number of players involved. Table 3 shows the rake for games with varying stakes.

Table 2 Sample Rake Structure – Maximum Rake			
	Two Players	Three to Four Players	Five or more Players
25/50, NL, Texas Hold'em, all other tables	1 units (\$/£/€)	2 units (\$/£/€)	5 units (\$/£/€)
25/50, NL, Texas Hold'em, all other tables	1 units (\$/£/€)	2 units (\$/£/€)	3 units (\$/£/€)

Table 3 Sample Rake for Games with Varying Stakes		
Game Stakes	Pot Size (\$/£/€)	Rake (\$/£/€)
2/4	5	0.25
	10	0.50
	15	0.75
	20	1.00
3/6	5	0.25
	10	0.50
	15	0.75
	20	1.00
5/10	10	0.50
	20	1.00
10/20 and higher	20	1.00
	40	2.00

¹⁷ The flop, in a poker hand, is the point at which the house begins turning cards after the initial hand is dealt.

The above example is somewhat typical of most poker websites, and helps to distinguish poker from other forms of gambling. More specifically, sites that make money from the rake do not collect the amounts wagered. In other words, the wagered amounts (net of the rake) are distributed to the players of the game. In other types of casino-style gambling, the house can, in most cases, collect the full amount of the wager (e.g. slots, blackjack, etc.).

Another important feature of Internet poker evolved as a result of its popularity – the abundance of player review and evaluation of existing sites. Due to the nature of poker, an experienced player can evaluate a particular website and determine somewhat conclusively if the site operates a fair game. This information has been widely circulated and has resulted in concentration of online poker playing in a few sites. The Internet poker community has created many venues to communicate and disseminate information to one another.

Another process that creates transparency in the game is that every hand played has a unique number, referred to as a hand number. This identifying number allows players to request player hand histories or investigate a potential problem with a specific hand. Players, by identifying that hand with the hand number, may review and report any potential problems with the hand. Even if players miss the hand number, they may note the hand number of the subsequent hand and make reference to the previous hand to investigate questions.

In addition, most Internet poker sites have features that allow both hand histories as well as table lists. Hand histories display a viewer (separate window) that keeps track of the hands dealt to the players. The table lists display information about the game, revealing limits, minimum and maximum number of players, and other details of the table's activities.

B. Areas of Concern

To reiterate, opposition to Internet gambling, including Internet poker is driven out of concern for the individual and a desire to protect US citizens. Before outlining the framework for a regulatory and legislative strategy, it is important to consider the concerns those regulations or laws would need to address. By focusing on the issues, the framework will then systematically address these issues and propose steps that offer both protections to US individuals and provide a remedy to the concerns.

Abusive Behaviors – Concerns with abusive behaviors typically refer to the potential for (1) money laundering by outside parties; (2) fraudulent websites or other businesses (typically financial) that develop simply to defraud potential Internet poker players; and (3) manipulating or cheating by game participants.

Compulsive or Problem Gambling – Concerns with compulsive gambling are similar to those for gambling in any venue. Compulsive or problem behaviors are apparent whether the individual is gambling in a physical location or on the Internet. However, the concern with Internet gambling is access. The individual would have unfettered

access to gambling sites throughout the day and night. Without adequate safeguards, problem gamblers might quickly face potential hardships through their Internet activities.

Underage Gambling – Concerns with Internet gambling include the anonymity of the Internet. Under the current system, authorities would have a limited ability to oversee or monitor underage gambling.

The following section addresses these concerns through a comprehensive regulatory and legislative approach. The regulatory ideas presented here are a catalogue of the existing knowledge, relying in particular on the efforts of the UK to regulate Internet gambling. However, some of the legislative and revenue ideas are an extension of present law relating to other areas of income and taxes, but not specifically related to Internet poker.

C. Regulatory Framework

Generally speaking, *industry experts believe that most areas of concern would be minimized, if not eliminated, through designing a comprehensive regulatory system.* The problem now facing the US is that a significant Internet poker industry already exists. Further this industry is supported largely by participants in the US. Currently there is little or no oversight or ability to collect fees or revenue from this industry.

In the UK, they are developing an extensive regulatory framework for the emerging Internet gaming industry. In addition, certain UK charities award certification to selected Internet gaming sites for excellence in operations. One such site, Party Gaming, was awarded this certification for the past two years. Further, Internet gaming websites established in Gibraltar are subject to regulation and oversight by their government. The government of Gibraltar developed and implements a variety of licensing and compliance systems, as much of their economic commerce arises from Internet activities.¹⁸

Following the framework of the UK, three critical areas for regulatory efforts include licensing, compliance, and enforcement. These areas would work in tandem to create a viable industry for online poker. They are an integral part of the success of developing a potential US industry.

Licensing – Generally speaking, a licensing requirement provides a means by which authorities may identify and oversee Internet poker site operators.

The ideal licensing process for the operators of the Internet poker web sites might include the following:

1. Applicants that desire to establish and operate an Internet poker site in the US would be required to complete a detailed application process. The applicant

¹⁸ See e-commerce at www.gibraltar.gov.gi/

would be required to provide proof of their identity and the individual would be subject to a background search to determine integrity or past criminal background.¹⁹

2. Each US Internet poker site must meet certain financial standards prior to operating their site. These standards might include posting a bond or other demonstration of financial ability. In addition, to meeting financial standards prior to operating the site, Internet poker sites would be required to maintain a certain financial standard throughout their operations. More specifically, they might be required, as banks and other financial institutions, to maintain a cash reserve that is in proportion to their average daily transactions.²⁰
3. US operators would be required to report certain changes in control of the operations and in some cases may be required to complete a new licensing application and undergo the review process. US operators would be responsible for maintaining their license in good standing and they would be required to meet certain standards throughout their operations.²¹
4. The Federal government would allow an appeals process for those operators that are denied a license to operate as well as those operators that might lose their license after beginning operations.²²

In addition, similar licensing requirements should also apply to software manufacturers:²³

1. Applicants that desire to develop and sell Internet poker software in the US would be required to complete a detailed application process. In addition, Internet poker sites might be required to maintain records and report, when necessary, any security breaches, complaints, or other problems.
2. A regulatory body would be required to conduct independent verification of the underlying algorithms in the software. While many software developers might raise concerns with sharing proprietary programming information, land-based casinos are required to verify the software used in their casinos.

Compliance – After licensing Internet poker companies in the US, there must be a means by which authorities may ensure compliance.

1. The US government might create an oversight board to review operations and ensure certain operating standards are met. The purpose of this board would be

¹⁹ Regulations in the UK require a similar application process for all gambling activity. See “Licensing, Compliance, and Enforcement,” by the UK Gaming Commission, 2006.

²⁰ Such standards are common for banks and other financial institutions.

²¹ Currently, changes in ownership and control of business operations must be reported to both the Internal Revenue Service as well as relevant state agencies.

²² Regulations in the UK require a similar review for applications that are denied. See “Licensing, Compliance, and Enforcement,” by the UK Gaming Commission, 2006.

²³ These are suggested regulatory proposals thought to address the concerns about allowing only viable and fair Internet poker sites. It would potentially discourage less reputable operations from being established.

to address such issues as fraudulent or abusive websites as well as cheating among players. Typically, the latter problems are easily detected through programming algorithms, according to many sources.²⁴

2. The oversight board would conduct regular, periodic visits that address specific issues as well as random or unannounced visits.
3. US Internet poker sites would be required to comply with provisions in the Patriot Act (concerning financial disclosure), as similar provisions currently apply to land-based casinos. Further, casinos must report all suspicious activities on the part of their players and a similar requirement is likely to apply to Internet poker sites. The compliance provisions might also include limitations on establishing accounts with cash.²⁵
4. Present law reporting requirements that require individuals to disclose certain cash amounts would extend to Internet poker activities. Both the site as well as the individual would be required to disclose such information.²⁶
5. If inadequate compliance exists, the oversight board may impose sanctions on Internet poker sites. These sanctions would be announced publicly and removal would occur only when the site demonstrates that it remedied the problems.

User Compliance – Individuals wishing to engage in Internet poker would be required to undergo an age verification process. This may include completing a disclosure form and providing a SSN that is then forwarded to the IRS. In any event, as in the UK case, the individual would be subject to penalties and fines for misreporting or falsely identifying him or herself as an adult, when they are in fact an underage individual.

Enforcement – Licensing and compliance efforts are of little value without some framework for enforcing those efforts. Therefore, any regulatory (and legislative) effort must include providing the means by which authorities may identify abusive behavior. Generally, these ends are achieved through explicit statutes or regulatory language which would grant (or extend to specific) law enforcement officials the authority to investigate and prosecute certain activities. In addition, other enforcement efforts might include:

1. Require that operators subject their operations to periodic audits of transactions (according to an industry study, one site conducts monthly audits).²⁷
2. The enforcement efforts might include substantial fines and/or prison terms for violations of the law. The enforcement authorities should periodically review and provide recommendations for updating the regulatory system, based upon its efficacy in protecting consumers.

²⁴ Such regulatory agencies currently operate at both the State and Federal level. For instance each state maintains a State Insurance Commission that provides guidance for insurance company operations.

²⁵ The US Patriot Act requires similar reporting of suspicious activity.

²⁶ Further US tax laws require certain reporting of cash transactions of \$10,000 or more.

²⁷ See Media and Entertainment Consulting Network, February 2005.

D. Legislative – Income Tax Provisions

One significant and overlooked benefit of bringing the online poker industry into the US mainstream economy is that a potential to collect revenue from both the businesses as well as the individual players exists for the US Federal government. In order to effectively impose tax on Internet poker, no new legislation is necessary as the Internal Revenue Code of 1986 (Code) provides tax treatment for other forms of gambling. The present law tax treatment would simply extend to Internet poker.

In theory, individuals who engage in Internet gambling (or any other form of gambling, legal or illegal) under current law are required to report their gambling winnings as income on their Federal income tax return. Taxpayers who itemize their deductions are permitted to deduct gambling losses. Current law applies to Internet gambling, in particular, because US citizens and residents are subject to US Federal income tax on their worldwide income. However, in reality, the compliance level with this requirement is likely to be very low because of the lack of recordkeeping and the absence of information reporting of these amounts.

In the case of the operators of Internet gambling web sites, current law is less clear because these are non-US operations.²⁸ The issue with respect to the Internet gambling businesses is whether they operate a business that is effectively connected with the US.²⁹ Despite the heavy use of Internet gambling sites by US citizens, it is unlikely that the US is collecting any Federal income tax on the earnings attributable to these businesses.

By clarifying the application of current law, the legislation would include provisions to ensure compliance with the tax system, as well as provision to impose tax on the earnings of the Internet poker net revenues.

Provisions to Impose Tax on Internet Poker Revenues – Current law specifies the tax treatment of gambling proceeds for both individuals as well as for businesses operating such a business. However, it is important to note that the Code specifically includes both legal and illegal gambling operations. So, despite the uncertain legal status of Internet gambling, the Code is quite clear about taxing the gains from those activities.

Despite the current provisions for the tax treatment of gambling, Internet poker revenues are likely to represent a new source of revenue, particularly on the individual

²⁸ Current law generally does not specifically address the issue of the income tax rules for Internet-based transactions and activities. Consequently, issues may arise as to the proper application of general US tax concepts to these activities in the case of cross-border Internet transactions, such as those that occur with Internet gambling. Significant issues include whether Internet-based gambling activities rise to the level of a taxable presence in the US and what is the “geographic source (foreign or US)” or income from Internet gambling activities.

²⁹ The DOJ argued successfully in one case that the illegal gambling operations were deemed to occur in both jurisdictions – in the US where the transaction originated and the overseas company where the transaction concluded. However, it is unclear whether this argument can be extended to income tax provisions because the US Federal tax law applies specific provisions to foreign source income and to foreign corporations operating in the US. In this case, the transaction may be deemed to occur in the US, but the foreign corporation does not occupy physically any US property.

side. If Internet poker firms establish operations in the US, the transactions with individuals would be subject to information reporting, as well as withholding. In addition, if Internet poker firms establish operations in the US, their domestic as well as worldwide income would be subject to US tax. Therefore, in order to collect revenues from both the individual taxpayer and the Internet poker site located in the US, the legislation must identify clearly the base of income and any exclusions or allowances permitted on that base.

Under current law, individual taxpayers are required to include in income any positive net poker proceeds. Treatment of gambling earnings under current law provides that proceeds from wagering are subject to a 25 percent withholding rate, for those amounts in excess of \$5,000. Further under current law, the individual may deduct losses only to the extent of the taxpayer's gains on similar wagering activities.

Current law allows professional gamblers (those whose primary source of income is gambling) to deduct directly from income losses associated with their gambling profession. However, nonprofessional gamblers must include all gambling earnings in income and claim the losses as an itemized deduction on Schedule A Form 1040.

With respect to corporations and other forms of businesses, US Federal tax law treats the Internet businesses operating in the US as it does all other businesses for tax purposes. In this case, the Internet poker businesses would be required to file Form 1120 and all related schedules and they would be subject to the maximum corporate tax rate (35 percent). In contrast, those Internet businesses that operate on foreign soil would not be subject to US income taxes or information reporting requirements, if the operations were not deemed to be effectively connected to the US.³⁰

Compliance – Reporting requirements would be necessary from both the Internet poker site, as well as from the credit card or other financial services corporation handling the payments to and from the site.

Under present law, certain gambling winnings are subject to withholding currently at a 25 percent rate. This amount withheld varies, but generally is equal to the product of the third lowest rate for individuals applied to the gambling winnings. Withholding is required on winnings in excess of \$5,000 from sweepstakes, lotteries and wagering pools.³¹

In addition, the payer of the winnings is required to report winnings in excess of \$600 (Form W-2G).³² Payers must also collect backup withholding if the individual does not provide a taxpayer identification number at the time the winnings are collected.

³⁰ However, through the licensing process, the US may seek to require international companies to report similar information for that portion of income generated by US citizens.

³¹ A similar provision exists for proceeds from wagering at pari-mutual pools for horse racing, dog racing, or Jai alai events. Withholding applies to amounts in excess of \$5,000 if it represents 300 times the original wager.

³² Generally, no information reporting or withholding is required on winnings from bingo or a slot machine on amounts less than \$1,200. Only amounts won in Keno in excess of \$1,500 are subject to information reporting and withholding.

Enforcement – Under present law, failure to comply with information reporting requirements results in the imposition of penalties assessed at the rate of \$100 per day up to a maximum \$50,000. An additional penalty of \$10 per day up to a maximum of \$5,000 is imposed on any officer, trustee, or employee who fails to file the return without reasonable cause.

E. Public Support – Educational Efforts

Current estimates indicate that less than one percent of all adults meet the criteria for pathological (compulsive) gambling. However, another 2 to 3 percent of adults exhibit signs of serious problems. Note that compulsive gambling statistics include all forms of gambling of which poker is only one.

Compared to other forms of addictive behavior, the impact of compulsive gambling on the general populations is quite limited. For instance, the prevalence of problem drinking was nearly 7 percent of the adult population in 2003. Another 27 percent of adults exhibited binge drinking behavior.³³

These disorders present certain characteristics, to varying degrees, in most individuals afflicted with a compulsive gambling problem. They include an inability to control their urge to gamble; increases in gambling frequency, time, or money spent gambling, and continuation of gambling despite serious consequences.³⁴

One of the benefits of clarifying the treatment of Internet poker is that it would provide resources to tackle the challenges of problem gambling. Gaming in Iowa completely self-funds all of their educational and community outreach programs. Therefore, clarifying the treatment of Internet poker would allow the industry the opportunity to self-fund programs that would address any potential problems.

In terms of practical approaches to addressing problem gambling before it creates serious financial and emotional hardships, there are several reporting requirements, as with land-based casinos, that might extend to Internet gaming. For instance, a land-based casino can restrict access to individuals with excessive losses. Further in some cases, casinos are believed to be liable if a family member informs the casino of another member's problem and they do not restrict that person's ability to gamble.

However, some find the third party reporting invasive and intrusive, so there are other alternatives. One approach is to require credit card companies and other issuers of credit to require an application for a separate line of credit on all gambling transaction

³³ Binge drinking or problem gambling refers to individuals that engage occasionally in that activity. However, problem drinking or compulsive gambling refers to individuals that engage consistently in that activity. The definitions vary with the frequency of the behavior. Statistics available from SAMSA of DHHS, at <http://oas.samhsa.gov/nhsda/2k3tabs/Sect2peTabs1to56.htm#tab2.24a>

³⁴ According to the National Commission on Problem Gambling, a combination of phone call-in centers, private counseling, and self-help groups provide positive results for most compulsive gamblers. They claim that these programs offer rewards far in excess of the associated costs.

through the credit card. This line of credit would be part of the individual cardholder's total credit, rather than an additional line.

In addition, the credit card company might offer a stop-loss mechanism (much like the daily limitation on ATM machines) to prevent excessive losses. Individuals, based on their total available credit may specify the amount. Further, another cosigner on the credit account must also agree to the stop-loss amount or the applicant would be denied credit.³⁵

Collectively, these practices implemented by the financial transaction companies might reduce the opportunity for problem gamblers to face serious financial problems.

³⁵ Note that Party Gaming provides customer-led controls for spending and session playing. Also, one recent development among credit card companies is to offer instant text messaging when charges in excess of a certain amount appear on the credit card account. This practice would be extended to accounts with gambling activity.

IV. OVERVIEW OF CURRENT LEGISLATIVE PROPOSALS

A. Legislative Proposals

There have been several legislative attempts to make Internet gambling illegal; however those efforts have not moved forward for several reasons. In addition to the lack of consensus in public opinion about Internet gambling, the efforts to advance legislation have failed because of the diverse nature of state laws on gambling. In many cases, states support lotteries as well as casino style gambling. (See Appendices B and C for a complete listing of state gambling activities.) Further, the popularity and expansion of Indian Gaming as well as horse racing facilities has made the Internet gambling prohibitions somewhat difficult to distinguish.

More recently, proposed legislation includes bills that have a wide range of objectives. They include bills that would make all Internet gambling illegal as well as those that would simply study and assess the issues.

H.R. 4411

One bill, H.R. 4411, introduced on November, 18, 2005, by Representative James Leach (Iowa, Republican) is the “Unlawful Internet Gambling Enforcement Act of 2006.”³⁶

Generally, H.R. 4411 would restrict the financial transactions to prevent wagering by individuals. More specifically, H.R. 4411 would amend the Federal criminal code to prohibit persons engaged in the business of betting or wagering from knowingly accepting credit, electronic fund transfers, checks, drafts, or similar instruments, or the proceeds of any other financial transaction in connection with unlawful Internet gambling. The bill would direct the Treasury Secretary and the Federal Reserve Board of Governors to prescribe regulations to identify and block restricted transactions and transmissions of wagering information. In addition, the bill would grant financial organizations immunity from civil liability for blocking transactions which they believe are restricted transactions.

The bill would grant jurisdiction to US district courts to prevent and restrain restricted transactions and further authorizes the Attorney General or any state Attorneys General to institute legal proceedings to prevent restricted transactions. H.R. 4411 would impose fines and/or a five-year prison term for violations. In addition, the bill expands the legal authority to allow prosecution of financial transaction providers, interactive computer services, or telecommunications services that have actual knowledge and control of bets and wagers and that operate an unlawful Internet gambling site.

H.R. 4411 calls for the US government to work with foreign governments to identify whether Internet gambling operations are used for money laundering, corruption or organized crime. In conjunction with other governments the Federal government would advance policies that promote international cooperation in enforcing H.R. 4411

³⁶ This bill was twice modified in 2006 and currently remains active.

and encourage the Financial Action Task Force on Money Laundering to study the extent to which Internet gambling operations are being used for money laundering purposes.

H.R. 4777

Representative Goodlatte (Virginia, Republican) reintroduced H.R. 4777, the “Internet Gambling Prohibition Act” on February 16, 2006. H.R. 4777 would amend Title 18 USC to expand and modernize the prohibition against interstate gambling.

H.R. 4777 would modify the definition of "wire communication facility" to include all Internet or other wireless communications, including transmissions by satellite or microwave using fixed or mobile connections. It expands the definition of "bets and wagers" to include all forms of gambling activity. H.R. 4777 would modify the existing prohibitions against interstate gambling to prohibit gambling businesses from using a communication facility to transmit bets or wagers. In addition, it would prohibit a communication which enables the recipient to receive money or credit as a result of bets or wagers. Further, it imposes a five-year prison term for violations of these laws.

As with H.R. 4411, the Goodlatte bill would prohibit anyone from receiving: (1) credit, or the proceeds of credit; (2) electronic funds transfers; (3) checks, drafts, or similar instruments; or (4) the proceeds of any other form of financial transaction as a result of wagering and gambling.

Effectively, H.R. 4777, by making Internet gambling illegal, would require any Internet provider to discontinue access to offshore gaming sites (effectively censure the Internet).

As with H.R. 4411, H.R. 4777 would authorize all levels of law enforcement agencies (Federal, state, tribal, or local) to take measure to prevent violations of this Act.

Kyl Proposal

Senator Jon Kyl (Arizona, Republican) has made nine unsuccessful attempts to move forward his legislation, the “Unlawful Internet Gambling Act.”³⁷ Most recently, he attempted to amend a House appropriations bill with Senate Amendment 1718. The appropriations bill, HR 2862, provided funding for the Departments of Commerce and Justice, Science, and related agencies for the fiscal year ending September 30, 2006. Senator Kyl attempted to amend that appropriations bill with his bill, in the form of an amendment (proposed September 15, 2005). The amendment would prevent the use of certain payment instruments, credit cards, and fund transfers for unlawful Internet gambling, and for other purposes.

³⁷ Note that Senator Kyl maintains an affiliation with the National Commission on Problem Gambling whose mission is to prevent problem gambling and assist in recovery those currently suffering from problem or compulsive gambling behavior.

H.R. 5760

In contrast to these efforts to make illegal all Internet gambling or restrict the financial transactions, there are several legislative efforts that acknowledge the presence and reality of Internet gambling. One such approach introduced in 2002 was a bi-partisan approach, H.R. 5760, introduced by Representatives John Conyers (Michigan, Democrat) and Chris Cannon (Utah, Republican).

H.R. 5760 proposed creating a five-member commission to study the existing online gambling industry and report in one year to the Congress of their findings. Within six months of the Commission's report, the Commission would be required to identify changes to Federal laws and regulations that would: (1) allow states to regulate gambling within their borders; (2) enact provisions to mitigate adverse impacts (underage gambling, money laundering, and problem gambling); (3) protect the authority granted Tribal enterprises; (4) make consistent all Federal laws that apply to Internet gambling; (5) provide for taxation and licensing of all Internet gambling activities; and (6) deter Americans from placing bets with unlicensed offshore sites.

H.R. 5474

More recently, H.R. 5474 was introduced (May 24, 2006) by Jon C. Porter (Nevada, Republican) to create a similar commission to study the proper response of the United States to the growth of Internet gambling.³⁸ The approach by Conyers and Cannon as well as Porter is consistent with the approach taken by the United Kingdom.

In 2004, the UK made sweeping modification to their existing gambling laws and specifically made legal Internet gambling. However implementation of the Internet provisions was delayed pending the results of a study by their Gambling Commission. The purpose of the study is to consider the ways that regulatory and legal channels might both prevent abuses and allow concrete means for legal authorities to pursue abusive activities. The first part of the Gambling Commission report was released in May, 2006. This report addresses issues relating to licensing, compliance, and enforcement. Clearly, the Conyers and Cannon as well as Porter approach is consistent with those efforts of the UK legislation. While the UK made Internet gambling legal, they delayed the effective date to consider adequately all the important issues.

³⁸ All bills referenced in this report are available online at <http://thomas.loc.gov>

V. CONCLUSION

Internet poker is a \$60 billion fast-growing industry. It operates largely outside of US laws and tax system. The benefits of bringing Internet poker into our system are considerable. Both US individuals and the Federal government would benefit from a comprehensive policy.

Clearly, as the world market grows, the US gambling industry (land-based casinos) will want to gain a stake in this growth industry. Further, if US sites are held to US laws and regulatory guidelines with regular oversight, US citizens might gain a comfort level with these businesses as opposed to those sites operated abroad.

In addition to encouraging compliance with regulations and standards, businesses located in the US would be subject to income tax under our current system. Further, if tax withholding would apply to all gambling amounts in excess of \$1,000, both making Internet poker part of our system and lowering this threshold would increase Federal revenues by *approximately \$3.3 billion* each year.

The Internet poker industry is firmly established in the lives of many US citizens. It is likely that the current industry growth is only an indication of the potential future growth and associated revenues. Given the social and revenue benefits of making Internet poker a viable industry, it is time for public policy to become more consistent with public opinion.

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APPENDIX A – Location of Internet Gambling Sites

Antigua	536	Gibraltar	111
Costa Rica	474	United Kingdom	70
Kahnawake Mohawk (Canada)	401	Belize	60
Curacao	343		

According to the American Gaming Association, eighty-five jurisdictions around the world currently regulate some form of online gambling. However, the businesses are concentrated in a few locations. Note, that all of these countries have legalized online gambling as an economic development strategy for attracting investment and jobs in a non-polluting, technology-based industry.

APPENDIX B – Legality of Gambling Under State Law

Table 5 – States that Allow Gambling by Type of Establishment				
State	Commercial	Tribal	Racing	Total
Nevada	258	2	0	260
Oklahoma	0	80+	3	83+
Colorado	46	2	0	48
California	0	43	0	43
South Dakota	36	11	0	47
Washington	0	31	0	31
Mississippi	29	1	0	30
Montana	0	30	0	30
Wisconsin	0	25	0	25
Michigan	3	21	0	24
Louisiana	18	3	0	21
Minnesota	0	20	0	20
New York	0	4	4	8
Iowa	13	1	3	17
Arizona	0	17	0	17
New Mexico	0	11	5	16
Missouri	11	1	0	12
New Jersey	12	0	0	12
Indiana	10	0	0	10
Illinois	9	0	0	9
Oregon	0	9	0	9
North Dakota	0	7	0	7
Florida	0	6	0	6
Idaho	0	6	0	6
Kansas	0	5	0	5
West Virginia	0	0	4	4
Nebraska	0	3	0	3
Delaware	0	0	3	3
Alaska	0	2	0	2
Connecticut	0	2	0	2
Rhode Island	0	0	2	2
North Carolina	0	2	0	2
Texas	0	1	0	1
Wyoming	0	1	0	1
Totals	445	347	24	816

Source: Oklahoma Association for Gambling Addiction and Awareness. Numbers compiled from AGA and NIGC data. Numbers may vary due to opening of new casinos since data compiled.

APPENDIX C – State Lottery Games and Revenues

Table 6 – States that Allow Lotteries Revenues and Sales (in Millions)		
State	Lottery Revenues	Lottery Sales
Arizona	79.7	249.8
California	711.9	2,063.0
Colorado	92.7	360.8
Connecticut	252.6	771.8
Delaware	34.2	359.2
DC	66.7	202.9
Florida	802.4	2,159.7
Georgia	558.5	1,720.2
Idaho	17.7	87.0
Illinois	571.2	1,623.5
Indiana	172.0	578.9
Iowa	42.5	173.7
Kansas	55.9	185.4
Kentucky	152.0	569.1
Louisiana	98.4	280.7
Maine	40.0	146.3
Maryland	392.3	1,035.7
Massachusetts	696.0	3,189.0
Michigan	563.4	1,599.3
Minnesota	84.1	368.5
Missouri	131.3	439.6
Montana	6.3	28.2
Nebraska	19.5	76.6
New Hampshire	51.3	176.8
New Jersey	612.4	1,556.1
New Mexico	20.5	82.1
New York	1,530.6	3,992.3
Ohio	750.4	2,300.0
Oregon	72.8	1,131.4
Pennsylvania	691.0	1,710.0
Rhode Island	42.2	548.7
South Dakota	5.9	533.2
Texas	1,161.1	3,745.4
Vermont	23.6	77.3
Virginia	331.1	920.8
Washington	94.2	408.2
West Virginia	43.9	515.4
Wisconsin	132.6	431.1
Totals	11,204.9	36,397.7

APPENDIX D

Odds and Probabilities in Poker Hands

Table 7 – Poker Hand Probabilities			
	<i>Hand</i>	<i>Probability</i>	<i>Approximately</i>
1.	Royal flush	0.000002	1 in 649,740
2.	Straight flush*	0.000014	1 in 72,193
3.	Four of a kind	0.000240	1 in 4,165
4.	Full house	0.001441	1 in 694
5.	Flush	0.001965	1 in 509
6.	Straight	0.003925	1 in 255
7.	Three of a kind	0.021129	1 in 47
8.	Two pairs	0.047539	1 in 21
9.	One pair	0.422569	1 in 2.4
10.	High card	0.501177	1 in 2
* <i>Excluding royal flushes</i>			

**Table 8 –
Odds and Probabilities in Texas Hold'em³⁹**

Number of Outs	1 Card Making on Turn		1 Card Making on River		2 Cards Making on Turn or River	
	<i>Probability</i>	<i>Odds Against</i>	<i>Probability</i>	<i>Odds Against</i>	<i>Probability</i>	<i>Odds Against</i>
21	44.7%	1.24	45.7%	1.19	69.9%	0.43
20	42.6%	1.35	43.5%	1.30	67.5%	0.48
19	40.4%	1.47	41.3%	1.42	65.0%	0.54
18	38.3%	1.61	39.1%	1.56	62.4%	0.60
17	36.2%	1.76	37.0%	1.71	59.8%	0.67
16	34.0%	1.94	34.8%	1.88	57.0%	0.75
15	31.9%	2.13	32.6%	2.07	54.1%	0.85
14	29.8%	2.36	30.4%	2.29	51.2%	0.95
13	27.7%	2.62	28.3%	2.54	48.1%	1.08
12	25.5%	2.92	26.1%	2.83	45.0%	1.22
11	23.4%	3.27	23.9%	3.18	41.7%	1.40
10	21.3%	3.70	21.7%	3.60	38.4%	1.60
9	19.1%	4.22	19.6%	4.11	35.0%	1.86
8	17.0%	4.88	17.4%	4.75	31.5%	2.18
7	14.9%	5.71	15.2%	5.57	27.8%	2.59
6	12.8%	6.83	13.0%	6.67	24.1%	3.14
5	10.6%	8.40	10.9%	8.20	20.4%	3.91
4	8.5%	10.75	8.7%	10.50	16.5%	5.07
3	6.4%	14.67	6.5%	14.33	12.5%	7.01
2	4.3%	22.50	4.3%	22.00	8.4%	10.88
1	2.1%	46.00	2.2%	45.00	4.3%	22.50

³⁹ From Cabot and Hannum, reference to Pots Odds Calculator, supra note 236; Texas Hold'em Outs and Odds, supra note 238.