An Economic Analysis of Regulating and Taxing Internet Poker:

Potential Revenue Effects of S. 1597 (Senator Menendez)*

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* The views expressed here are those of Quantria Strategies, LLC and do not necessarily represent the views of the Interactive Gaming Council. We alone are responsible for any errors.

Abstract

This Study examines the likely effect on Federal tax revenues of S. 1597, a bill that would regulate and tax Internet poker. Our analysis supplements and extends earlier research on legislation that is similar, but much broader in scope. Our principal finding is that limiting the licensing and taxing of Internet gambling to games of skill (e.g., poker) can still result in substantial additional revenues to the US Treasury over and above what a simple analysis based on market segments might suggest. In addition, states that elect to not opt-out under the new regulatory regime are also likely to see significant increases in budget receipts.

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Executive Summary

- Internet gambling is illegal in the United States. Worldwide, however, interactive gaming is the fastest growing gambling venue in the world today.

- Americans contribute more than $4 billion annually to the income of existing offshore interactive poker sites and this figure is expected to triple over the next 10 years.

- The Federal government receives no economic benefit from internet poker because most of the activity occurs outside US borders.

- Regulating and taxing Internet gambling activity of Americans will provide a potentially large, stable, and ongoing source of revenue for the Federal government.

- This study examines the potential revenue effect of S. 1597, a bill that would regulate and tax Internet poker in the United States.

- We estimate that the Federal government would collect between $5.9 billion and $24.5 billion in additional revenue over the next 10 years if S. 1597 were to become law under alternative assumptions relating to state Opt-Outs:

Assumption	Estimated Revenue Effect (Fiscal Years 2010-2019) *(Millions of Dollars)*
High Opt-Out	5,865.8
Medium Opt-Out	**13,908.1**
Low Opt-Out	18,746.6
All States	24,486.1

- Additionally, states could receive a substantial revenue windfall under S. 1597. We estimate this additional revenue to be between $2.4 billion and $8.4 billion depending on how many states elect to allow Internet poker. The five states that could experience the largest potential revenue increases are:

State	Estimated Revenue Effect (Fiscal Years 2010-2019) *(Millions of Dollars)*
California	1,312.7
New York	697.4
Illinois	418.9
New Jersey	359.9
Ohio	295.0

- Our analysis supplements existing research on the revenue effect of legalizing and taxing all forms of Internet gambling, not just poker.

- We identify several reasons that, by limiting the scope of existing legislation to games of skill (i.e., poker), the resulting revenue effect is likely to be much larger than a simple market segment analysis might suggest.

I. Introduction

Internet gambling is illegal in the United States. Despite this fact, millions of Americans place wagers with offshore operators of online betting sites every year. This gambling takes many forms, including casino gambling, lotteries, sports wagering, and poker. In fact, Internet gambling is currently the fastest growing segment of the gambling industry resulting in an increasing number of jobs and tax revenues flowing overseas.

Two bills currently under consideration by the Congress propose to alter the way the United States regulates and taxes Internet gambling. In the US House of Representatives, H.R. 2268 (Rep. McDermott) would legalize and tax all Internet gambling.[1] In the US Senate, S. 1597 (Sen. Menendez) would limit online betting to poker and other Internet games of skill.[2]

Last October, the Joint Committee on Taxation (JCT) released a revenue estimate of H.R. 2268 indicating that the Federal government could see revenues increase by as much as $40 billion over the next ten years if this bill became law and all fifty states elect to participate. This analysis considers the change in the revenue effect, if the legislation was limited only to online poker as proposed in S. 1597.

It is important to point out that JCT's revenue estimate of H.R. 2268 is not in dispute. Our purpose is to demonstrate that, in order to isolate the revenue effect of Internet poker only, apportioning the total effect according to poker's existing market share would be misleading. There are important behavioral responses on the part of gamblers and state governments that should be considered when estimating the correct effect on Federal tax revenues. Further, as indicated below, there is a remarkable degree of consistency in similar analyses conducted by other research organizations, supporting the original JCT revenue estimate and the analysis in this paper.

In this paper, we first discuss the current legal and regulatory landscape with respect to Internet gambling. Next, we review the existing literature on the economics of gambling. This review will suggest what aspects of gambling are likely to drive the behavior of Internet gamblers. After comparing each of the bills and how they address the regulation and taxing of Internet gambling, we review JCT's estimates and suggest how they may change if only applied to Internet poker. Finally, we offer our conclusions.

[1] A companion bill, H.R. 2267, provides the regulatory framework for legalizing Internet gambling. H.R. 2268 contains the tax provisions.
[2] The bills have other significant differences that we discuss below.

II. Present Law Treatment of Internet Gambling

Currently, Internet gambling is illegal in the United States. The basis for this is the Department of Justice's (DOJ) interpretation of the Federal "Wire Act" of 1961, which prohibits transmitting bets over the telephone (the "wire"). While there is some disagreement among the legal profession about the ability of the DOJ to prosecute Internet gambling under the Wire Act, this legal position has been taken by the previous two Administrations, who argued that the statute prohibits all forms of Internet wagering. The DOJ has never prosecuted an individual for placing a wager over the Internet but has used their authority and interpretation of the law in criminal enforcement actions against Internet gambling operators.

In October of 2006, Congress passed the "Unlawful Internet Gaming Enforcement Act" (UIGEA) that took a different approach in regulating Internet gambling. Under UIGEA, financial firms (e.g., banks) were prohibited from transferring funds to offshore entities for the purpose of gambling. Prior to the passage of UIGEA, US players accounted for approximately $8 billion annually to all forms of Internet gaming.[3] Since 2006, no US-based Internet gambling sites exist. All Internet gambling by US players is done through offshore sites and UIGEA has proved ineffective in stopping the transfer of funds to these establishments for some gamblers.[4]

Gross revenue estimates in the global Internet gambling market exceeded $21 billion in 2008. Approximately $6 billion of that gross revenue is attributable to US players, a reduction since the passage of UIGEA.[5] However, with the entry of smaller payment solutions, most observers believe this figure will continue to grow in the future, as Internet gambling is the fastest growing sector of the industry.

In the United States, legalized land-based gambling is regulated by state governments and all but two states support some form of legalized gaming.[6] For example, most states support some type of lottery to supplement revenue collections. If Internet gambling were made legal in the United States, state governments would decide whether this form of entertainment would be allowed within their borders.

An important policy consideration is whether the United States can afford to allow billions of dollars in foregone tax revenue – in addition to jobs and related business activity – to continue to flow overseas.

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[3] H2 Gambling Capital (2008).

[4] According to H2 Gambling Capital (2008): "Despite UIGEA, numerous privately owned companies continue to target the US market. Trading conditions became more difficult during January 2007 when Neteller, the leading online wallet provide (sic), withdrew from the US market. However, numerous smaller payment solutions have since filled the void and a number of US banks continue not to block the '7995' online gambling transaction code." P 8.

[5] Ibid.

[6] Hawaii and Utah do not have any type of legalized gambling.

III. Economics of Gambling

Until recently there has been very little analysis of the economics of gambling in the United States. No doubt, this is partly due to the fact that reliable data on this sector of the economy did not exist until recently. Over the last twenty years, legalized gambling has grown tremendously in the United States as state governments rely more and more on gambling (e.g., state lotteries) as a revenue source.[7] An important policy question is whether the introduction of additional gambling alternatives, such as Internet gambling, will help or harm existing land-based operations.

Economists treat gambling as they would any other commodity: there is a supply and a demand for gambling, just as there is for any other type of commodity (e.g., entertainment). Also, like other commodities, gambling has a "price" that will influence the quantity that is demanded, although with gambling this price is usually difficult to calculate.

Of particular interest to policymakers is whether certain types of gambling are substitutes or complements, either among themselves or with respect to other commodities. When a good is a substitute with respect to another good, then an increase in the demand for one will lead to a reduction in demand for another. If two goods are complements, then an increase (decrease) in the demand for one will lead to an increase (decrease) in the demand for the other. When examining the potential revenue effects of regulating and taxing Internet gambling, it is important to ascertain if this type of gambling is merely a substitute for existing forms of legalized, land-based gaming or perhaps complementary. If Internet gambling is a substitute for other forms of legalized gambling, then any Federal tax revenue collected will be offset by reductions in revenues from land-based gaming operations.

Recently, there have been several studies that examined the demand for gambling in the United States and the United Kingdom.[8] A common framework in these studies is to estimate an econometric model of the demand for various types of gambling. The models are generally formulated as aggregate (i.e., macro), time-series models that consider variations in demand over time and across regions. The models suffer from a lack of reliable data on important model inputs because so much of legalized gambling, particularly in the United States, takes place in locales where data is kept confidential (e.g., Indian tribal casinos).

In econometric models that estimate demand, one usually has available a price from which one can test hypotheses about how this affects demand. The correct "price" for different forms of gambling is either not observed directly or is difficult to calculate. In addition, because much legalized gambling is operated as a government monopoly (e.g.,

[7] State-run gambling operations often compete with Indian casinos that are independent entities and can't be taxed in the United States.

[8] Much of this discussion is drawn from Paton, et. al. (2003). See also Siegel and Anders (2001) and Kearney (2005).

state lotteries), demand is driven more by government regulation and prices are effectively set by government entities.[9]

With these caveats, the following results should be of interest to policymakers:[10]

- There appears to be a strong substitution effect between amounts bet in state lotteries and casinos with lottery revenue displaced by the introduction of casino gambling.

- In the United Kingdom, the own-price elasticity of the national lottery is approximately -1.0.

- In the United States, the own-price elasticity of state-run lotteries is significantly larger than -1.0 (Paton, et.al. (2003).[11]

- Socioeconomic factors can have important effects on the demand for gambling. In particular, most forms of gambling have a positive income effect: gambling increases with incomes.

- There is limited evidence of any substitution effect among other forms of gambling. In the United States, there is some evidence that the introduction of riverboat gambling in some states has displaced revenues from other types of entertainment.

- There are no studies of which we are aware that examine the demand for Internet gambling or whether it is a substitute or complement for land-based gambling.

[9] A common approach to measuring the price of gambling is the "take-out" rate: the amount of winnings withheld by the state. Other authors maintain that the true price should be calculated according to the probability of winning.

[10] Economists use the term "elasticity" to describe how consumers respond to price changes. Mathematically, the own-price elasticity of a good is calculated as the percentage change in the quantity demanded divided by the percentage change in the price. When this ratio is greater than one (in absolute value), demand for the commodity changes more than the corresponding price change in percentage terms and the demand is referred to as "elastic". Similarly, when the own-price elasticity is close to zero, then the demand is "inelastic", or unresponsive to changes in price. When the own-price elasticity of demand is equal to one, the demand for the commodity exhibits "unitary" elasticity and changes in prices result in offsetting changes in the quantity demanded leaving revenues unchanged.

[11] The authors speculate that this finding is the result of the large number of state-run lotteries competing with one another in contrast to one national lottery in the United Kingdom.

IV. Proposed Legislation Affecting Internet Gambling

Three bills presently before Congress would change the way Internet gambling would be regulated and taxed. In the House, H.R. 2267 (Rep. Frank) provides the regulatory framework for legalized Internet gambling, while H.R. 2268 (Rep. McDermott) codifies its tax treatment. In the Senate. S. 1597 (Sen. Menendez) addresses both the regulatory and tax treatment for legalized Internet gambling.

The tax treatment of legalized Internet gambling under H.R. 2268 and S. 1597 is determined, in part, by similar regulatory regimes. In this study, we only focus on the tax provisions contained in both bills and only make note of the regulatory aspects to the extent they make a material difference in the revenue effect of either bill.

Briefly, the tax provisions contained in H.R. 2268 would assess a gambling license fee on operators of Internet gambling sites based on amounts deposited by online gamblers. S. 1597 would impose a similar gambling license fee, but it would be limited to Internet poker and other Internet "games of skill." Both bills contain strict tax enforcement provisions by implementing comprehensive income reporting and backup withholding for certain taxpayers.

A. H.R. 2268 (Rep. McDermott)

H.R. 2268 would impose a license fee on the operators of Internet gambling establishments located in the United States. The fee would be set at 2 percent of the amounts deposited into accounts held by customers for the purposes of placing Internet wagers. A fee of 50 percent would be charged for wagers made to illegal Internet gambling establishments.

Information reporting requirements are also imposed for those establishments with Internet gambling licenses. Among other things, the licensee is required to report the name, address, taxpayer identification number (TIN), annual winnings, net winnings, beginning-of-year and end-of-year account balances, and the amount of any taxes withheld. Backup withholding is also implemented as well as withholding on the winnings of nonresident aliens. Net winnings are defined as gross winnings less amounts wagered. Net winnings cannot be negative.

The effective date of H.R. 2268 is for wagers placed after the date of enactment.

B. S. 1597 (Sen. Menendez)

S. 1597 would allow for the regulation and taxing of Internet poker and similar "games of skill." It would impose a license fee under a two-tiered structure: (i) a Federal Internet Gaming license fee and (ii) a State or Indian Tribal Government license fee. Both fees would be set at 5 percent of the amounts deposited into accounts held by customers for the purpose of placing Internet wagers. The gambling establishment would be assessed

both the Federal and State (or Indian Tribal Government) fees.[12] The fee would be increased to 50 percent for wagers made from unlicensed operators. The State (or Indian Tribal Government) fee would only be imposed once; if the customer is located within the jurisdiction of an Indian tribe at the time of the transaction, only the Indian Tribal Government fee would be collected and the entire amount of the fee would be allocated to the Indian tribal government.

Information reporting requirements would be imposed on licensed operators. The information required to be supplied by January 31 following the calendar year for which the information is provided includes the following information: the name, address, and taxpayer identification number (TIN) of the licensed operator; the name, address, and TIN of each person placing a bet or wager with the licensed operator during the calendar year, the gross winnings, gross wagers, and gross losses for each person placing a bet or wager; the net winnings for each person placing a bet or wager; the amount of any taxes withheld; the beginning and end-of-year account balances for each person placing a bet or wager; and the amounts of all deposits and withdrawals from an individual's account during the year. Backup withholding is also implemented as well as withholding on the winnings of nonresident aliens. Net winnings are defined as gross winnings less amounts wagered. Net winnings cannot be negative.

The bill provides for a trust fund to be established for the disbursement of the State and Indian tribal fees. States have the election to opt-out of the regulatory regime under the bill. The effective date of the legislation is for deposits made after the date of enactment.

In this study, we examine how the tax provisions affecting Internet gambling in each bill are likely to affect Federal revenues. We summarize these provisions in Table 1.

[12] Only one fee is imposed at the State level. That is, an establishment is assessed a State fee or an Indian tribal fee but not both.

Table 1. – Comparison of the Tax Provisions Affecting Internet Gambling in H.R. 2268 and S. 1597

Provision	House Bill (H.R. 2268)	Senate Bill (S. 1597)
A. License Fee		
A.1 Federal Internet Gaming License Fee	2 Percent of All Funds Deposited by Customers	5 Percent of All Funds Deposited by Customers
A.2 State or Indian Tribal License Fee	No Provision	5 Percent of All Funds Deposited by Customers
B. Illegal Wagering	50 Percent Fee (Penalty) for Wagers Placed by Unlicensed Operators.	Same as House Bill
C. Gambling Covered	All Internet Gambling	Internet Games of Skill Only (e.g., Poker)
D. Record Keeping Requirements	Information Returns: (i) Name, Address and TIN of Licensee (ii) Name, Address and TIN of Wagerers (iii) Gross Winnings (iv) Gross Wagers (v) Gross Losses (vi) Net Internet Gaming Winnings (vii) Tax Withheld (viii)Beginning-of-Year and End-of-Year Account Balances (ix) Deposits and Withdrawals	Same as House Bill
E. Definition of Net Internet Gaming Winnings	Gross Winnings less Amounts Wagered	Same as House Bill
F. Backup Withholding	Yes	Yes
G. Withholding on Non-Resident Aliens	Yes	Yes
H. Establishment of a Trust Fund	No Provision	For the Disbursement of State and Indian Funds
I. Effective Date	Deposits Made After Date of Enactment	Same as House Bill

V. Estimated Revenue Effects

If Internet gambling were regulated and taxed under S. 1597, the Federal government would see revenues increase through several channels. First, the 5 percent Federal license fee on customer deposits would generate an immediate revenue effect from those establishments that set up business in the United States. Second, application of the existing wagering tax under Section 4401 in those states that do not opt out of the regulatory framework would provide an additional source of revenue. Third, individual income tax receipts would increase due to increased compliance that is a direct result of the information reporting requirements contained in the bill.[13] Fourth, corporate income tax receipts would go up as existing offshore Internet gambling sites relocate back to the United States.

While not directly addressed by the JCT, state revenues will also increase in those jurisdictions that do not opt-out of the regulatory framework of S. 1597. These additional revenues will flow from the parallel, 5 percent license fee imposed and distributed to states and tribal governments and from increased state individual and corporate income taxes in those states that tax these income sources.

In our analysis, we first examine the likely revenue effect of S. 1597 on Federal tax receipts. Next, we look at how states are likely to fare if they elect to opt into the new regulatory framework.

Federal Revenue Effects

In October 2009, the JCT released revenue estimates for H.R. 2268 under various alternate assumptions. In particular, each estimate assumed that (i) Internet wagers would be subject to the existing Federal excise tax on "state authorized wagers;"[14] (ii) betting on professional and amateur sports would be prohibited; (iii) Internet gambling licensees must be incorporated in the United States and senior management and computer equipment must be located in the United States; and (iv) the regulatory provisions in H.R. 2267 are in place. In addition, the JCT provided separate estimates assuming a license fee of 2 percent (as introduced), 4 percent and 6 percent. A separate estimate for the 2 percent fee was presented assuming, in addition to (i)-(iv), that no state could opt-out of the regulatory regime. We summarize the JCT revenue estimates in Table 2.

It is important to point out that the JCT revenue estimates of H.R. 2267 and H.R. 2268 are not in dispute. In fact, as we show below, there is a remarkable degree of consistency with estimates of similar legislation from different research groups. Our purpose is to provide some guidance relating to how these estimates might differ if the legislation was modified to only affect Internet poker as is the case under S. 1597.

[13] This revenue will also include increased income tax receipts from non-resident aliens that choose to gamble on US owned and operated sites.
[14] An excise tax equal to 0.25 percent of state authorized wagers is imposed under Section 4401.

Table 2. – JCT Revenue Estimates Under Alternative Assumptions

(Millions of Dollars)

Item	Variation	Fiscal Years 2010 to 2019
1	H.R. 2268 as introduced *	10,017
2	H.R. 2268 with 4 percent license fee	11,689
3	H.R. 2268 with 6 percent license fee	13,146
4	H.R. 2268 as introduced but no state opt-out	41,815

Source: Joint Committee on Taxation. Letter to Congressman McDermott, October 23rd, 2009.

* All estimates make the assumptions outlined in (i)-(iv) above.

To put these estimates in perspective, it is useful to look at some independent estimates of the likely size of the US Internet gambling market over the same period. Table 3 shows forecasts of the likely gross revenues of a legalized Internet gambling market in all 50 states for 2010-2019.[15]

Table 3. – Forecast of the Size of a Legalized US Internet Gambling Market, by Type of Gambling, 2010 to 2019

(Millions of Dollars)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Sportsbetting	5,238.1	7,622.2	9,724.1	11,544.7	13,418.7	15,306.6	16,968.5	18,345.1	19,446.8	20,436.4
Casino	4,375.1	6,347.8	7,741.4	8,895.1	10,044.4	11,169.1	12,134.2	12,917.6	13,535.0	14,083.1
Poker	4,410.7	5,710.3	7,142.4	8,598.0	9,943.9	10,941.6	11,761.8	12,414.5	12,998.2	13,499.5
Bingo	930.7	1,381.2	1,704.8	1,976.0	2,248.5	2,517.2	2,749.4	2,938.8	3,088.8	3,222.3
Skill/Other Gaming	777.0	963.5	1,251.9	1,506.3	1,771.7	2,042.3	2,283.0	2,484.0	2,646.0	2,792.1
Total	15,731.6	22,025.0	27,564.6	32,520.1	37,427.2	41,976.8	45,896.9	49,100.0	51,714.8	54,033.4

Source: *H2 Gaming Capital (H2GC)*

The figures show that over the next ten years, Internet poker is expected to generate close to $100 billion in revenues from US players. In terms of market share, Internet poker is forecast to comprise in excess of 40 percent of the total, non-sports betting landscape, second only to online casino gambling (42.2 percent). Other games of skill are forecasted to generate an additional $18.5 billion (or about 7.7 percent of the total) in revenues, but it is unclear just how much of this activity would qualify as legalized gambling under S. 1597.

Importantly, a recent PricewaterhouseCoopers (PwC) analysis of similar legislation that also relied on the H2GC data showed an estimated revenue effect of a 2 percent license fee of $10,869 billion for Fiscal Years 2009 to 2018, very close to the JCT's estimate (see Item 1 in Table 2).[16] Similarly, the PwC estimate of legislation assuming that no state opts out of the regulatory framework is $39,963 billion over the same period. Again, this estimate is very close to JCT's estimate (Item 4 in Table 2).[17]

[15] These figures were prepared by H2 Gambling Capital (H2GC), a market analysis firm specializing in Internet gaming. In addition, it is important to point out that the figures relate to the "yield" that would be realized by Internet gaming operators after winnings are distributed to customers.

[16] PricewaterhouseCoopers (2008). The estimate reflects an assumption that a "high opt-out" for states and Internet sports betting is prohibited.

[17] Our own, admittedly rough, calculation yields a similar result. Relying on the figures in Table 3, we apply the 2 percent licensing fee to non-sports betting over the 2010-2019 period after "grossing-up" the yield figures and apply a 25 percent Federal offset to this figure. To this amount, we add the 0.25 percent

Incentives for States to Not Opt-Out Under S. 1597

A crucial assumption underlying JCT's revenue estimate is just how many states will opt-out under the new regulatory system and allow Internet poker sites within their borders. The JCT figures suggest that only about one-quarter of the potential revenue would be realized under H.R. 2268 if states are given this option.[18] It is important to realize, however, that H.R. 2268 would legalize all Internet gambling, not just poker, and there are several reasons to believe that additional states might not opt-out under a more narrowly crafted bill. These reasons include:

- S. 1597 includes a parallel license fee that would be distributed directly to the states from a Federally-managed Trust Fund – an additional source of revenue not present in the House bill.

- In the present economic environment, state governments have been hit particularly hard and many states are in desperate need for additional revenue sources. States that might not otherwise allow Internet gambling might look more favorably at this option under S. 1597.

- Importantly, states must pro-actively opt-out of the regulatory framework of S. 1597 and this may be difficult to do, both politically and legislatively, in some circumstances.

- Poker is a distinctly American game with a long history in this country. It is likely that poker may be accepted more by the public than other forms of gambling.

- In addition, for those who may find poker unacceptable, Internet poker allows the activity to continue without the visibility of traditional brick and mortar gaming establishments.

- To the extent additional states allow Internet poker under S. 1597, it is likely there would be a "cascading effect" as neighboring states would move to protect much-needed revenue from flowing out of the state.[19]

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wagering tax on the grossed-up figures. To arrive at the individual income tax component, we assume that about 16 percent of the reported winnings represent winnings not presently captured by the US tax system and apply an average marginal tax rate of 27.2 percent. This tax rate was calculated from Quantria Strategies Individual Income Tax Microsimulation model by examining changes in "Other Income," which is the component of Federal Adjusted Gross Income where gambling winnings are reported. To arrive at an estimate of additional corporate income taxes, we apply the current maximum corporate tax rate of 35 percent to the gross yield of operators, after adjusting for other deductions from net income. Finally, and in keeping with standard revenue estimating convention that GDP remain constant, we assume that only 10 percent of this additional income is not shifted from other sources. This calculation yields an estimate of $37,836.0 billion.

[18] Compare items 1 and 4 in Table 2.

[19] Similar "neighbor" effects were observed in the adoption of state lotteries and casino gambling.

- The increasing popularity of Internet poker and televised poker tournaments, in addition to an expected flurry of advertising should this form of entertainment be legalized, would put pressure on state governments to adopt the new regulations.

- Twenty-four states presently have licensed poker and these states account for more that 55 percent of the personal income in the United States. It is likely that these states would not opt-out under the narrower bill.[20]

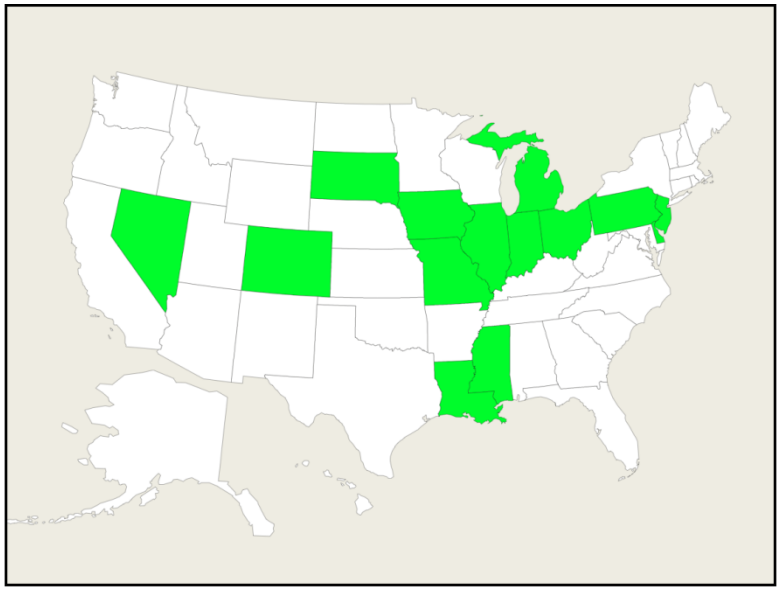
Below we provide estimates of S. 1597 under four alternative scenarios regarding states' opting-out of the new regulatory regime:

1. High Opt-Out Assumption. Under this assumption, we assume that only states with existing licensed casino gambling and/or table gaming would allow Internet poker within their borders. This conservative assumption seems consistent with the JCT's revenue estimate of H.R. 2268.[21]
2. Medium Opt-Out Assumption. In our mid-point estimate of S. 1597, we assume that those states that presently allow licensed poker will not opt-out. This assumption seems reasonable in light of the arguments outlined above.
3. Low Opt-Out Assumption. Under this assumption, all states that do not opt-out under our Medium scenario are joined by those states that have large population centers near two or more of these states.[22]
4. No States Opt-Out. Under this scenario, we estimate the revenue effect if all states (and the District of Columbia) were to allow Internet poker under S. 1597.

Figures 1-3 summarize our assumptions regarding state opt-outs under our low, medium, and high scenarios.

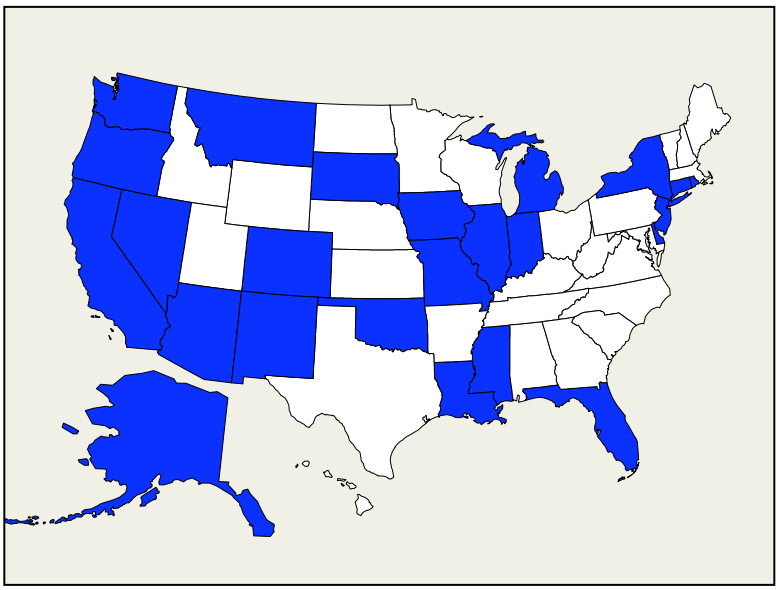
[20] Existing state regulations on gambling are summarized in Appendix A1.
[21] While we do not know exactly what JCT's assumptions are as to state take-up rates under H.R. 2268, our calculations under this scenario yield results that are very close to their estimates.
[22] These additional states and their respective neighbors are: Kansas (Missouri, Oklahoma and Colorado), Maryland (Delaware and West Virginia), Massachusetts (New York, Connecticut and Rhode Island), Nebraska (South Dakota, Iowa and Missouri), Pennsylvania (New York, New Jersey and Delaware), Texas (New Mexico, Oklahoma and Louisiana), and Wisconsin (Iowa, Illinois and Michigan).

Figure 1. – HIGH State Opt-Out Assumption (Licensed Casino/Table Gambling Only) (states in green are assumed Not to Opt Out)



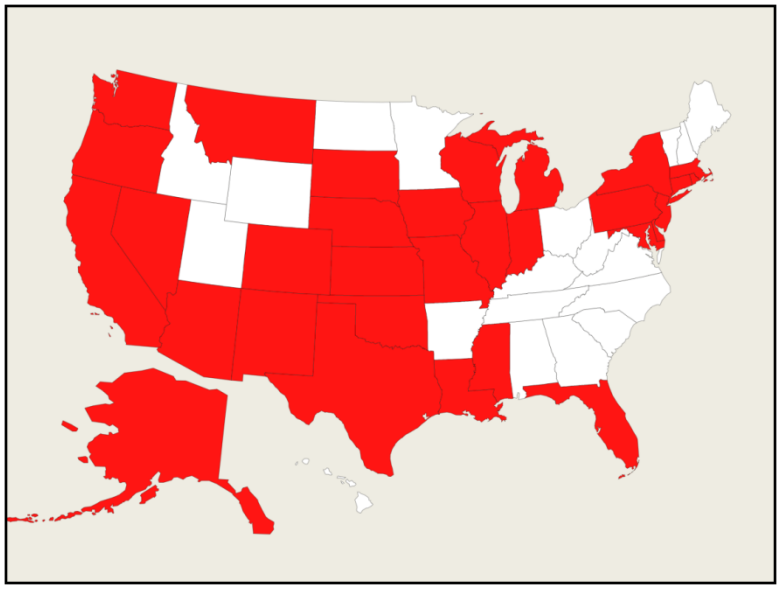
1. Colorado
2. Delaware
3. Illinois
4. Indiana
5. Iowa
6. Louisiana
7. Michigan
8. Mississippi
9. Missouri
10. Nevada
11. New Jersey
12. Ohio
13. Pennsylvania
14. South Dakota

Figure 2. – MEDIUM State Opt-Out Assumption (Licensed Poker Only)
(states in blue are assumed Not to Opt Out)



1. Alaska
2. Arizona
3. California
4. Colorado
5. Connecticut
6. Delaware
7. Florida
8. Illinois
9. Indiana
10. Iowa
11. Louisiana
12. Michigan
13. Mississippi
14. Missouri
15. Montana
16. Nevada
17. New Jersey
18. New Mexico
19. New York
20. Oklahoma
21. Oregon
22. Rhode Island
23. South Dakota
24. Washington

Figure 3. – LOW State Opt-Out Assumption (Licensed Poker Plus States With Neighbors Not Opting-Out Under MEDIUM Assumption)
(states in red are assumed Not to Opt Out)



1.Alaska
2.Arizona
3.California
4.Colorado
5.Connecticut
6.Delaware
7.Florida
8.Illinois
9.Indiana
10.Iowa
11.Louisiana
12.Michigan
13.Mississippi
14.Missouri
15.Montana
16.Nevada
17.New Jersey
18.New Mexico
19.New York
20.Oklahoma
21.Oregon
22.Rhode Island
23.South Dakota
24.Washington
25. Kansas
26. Maryland
27. Massachusetts
28. Nebraska
29. Pennsylvania
30. Texas
31. Wisconsin

We rely on the JCT estimates to approximate the potential revenue effect of S. 1597. First, we adjust the JCT estimates to reflect the fact that S. 1597 imposes a 5 percent license fee. Second, we estimate the share of this amount attributable to Internet poker based on data contained in Table 3. Third, we adjust these figures to reflect certain behavioral responses that we believe will occur should S. 1597 become law. These responses are:

1. An increase in the amounts wagered on other "games of skill" that would qualify under the bill. Certain non-poker games of skill will become legal under S. 1597. We estimate this amount to be one-half of the total forecasted wagering in the fourth line of Table 3.

2. A small substitution effect of non-poker Internet gambling to legalized poker. While there is no evidence of a substantial substitution effect among other forms of "brick-and-mortar" gambling, we believe that there could be a small effect due the different nature (i.e., the "experience") of online gambling. We estimate this effect to be 5 percent of non-poker gambling not otherwise qualifying under the bill.

In Table 4, we summarize our estimates of S. 1597 under alternative assumptions relating to state opt-outs. Under our midpoint scenario, we estimate that Federal budget receipts would increase by $13.9 billion over the 2010-2019 budget period. This figure reflects, in addition to more states not opting-out under the bill, the higher license fee imposed; new, non-poker games of skill that would qualify; and a small substitution effect.

Under our Low Opt-Out scenario, we estimate that the Federal government would see revenues increase by about $18.7 billion over this same period. As a point of reference, we estimate that if no states were to opt-out under S. 1597, approximately $24.5 billion in additional revenues would be realized over the 2010 to 2019 budget horizon.

In arriving at Item 4, we simply average the JCT estimate of a 4 percent license fee with their estimate of a 6 percent license fee. Item 4 reflects an estimate of what a 5 percent license fee would raise in additional revenue if limited to Internet Poker only *and assuming no behavioral response*. Item 5 reflects our assumption that, absent any behavioral response, Internet poker represents about 40 percent of all non-sports, Internet gambling over the time horizon. Items 6 and 7 reflect our estimates of the behavioral effects outlined above. In estimating the revenue effect under alternative scenarios about state opt-outs, we use state personal income shares for each state assumed not to opt-out and apply this percentage to JCT's revenue estimate assuming all states participate (Item 4 in Table 2).[23]

[23] These state income shares are shown in Appendix A2.

Table 4. – Estimate of the Potential Revenue Effect of S. 1597: Limiting Legalized Internet Gambling to Poker and Other Games of Skill

		Fiscal Years 2010 to 2019 (Millions of Dollars)			
ITEM	Adjustment	High Opt-Out	Medium Opt-Out	Low Opt-Out	All States
			(Estimated)	*(Estimated)*	*(Estimated)*
1	JCT Estimate of H.R. 2268 @ 2% License Fee	10,017.0	23,750.9	32,013.6	41,815.0
2	JCT Estimate of H.R. 2268 @ 4% License Fee	11,689.0	27,715.4	37,357.2	48,794.6
3	JCT Estimate of H.R. 2268 @ 6% License Fee	13,146.0	31,170.0	42,013.6	54,876.8
4	Estimate Assuming 5% License Fee	12,417.5	29,442.7	39,685.4	51,835.7
5	Poker Share Before Behavioral Adjustments (40.6%)	5,041.5	11,953.7	16,112.3	21,045.3
	Estimated Behavioral Effects:				
6	"New" Games of Skill That Qualify	479.4	1,136.8	1,532.3	2,001.4
7	Substitution Effect (Non-Poker to Poker)	344.8	817.6	1,102.0	1,439.5
Total	Estimated Revenue Effect of S. 1597	5,865.8	13,908.1	18,746.6	24,486.1

Source: *Quantria Strategies, LLC*

S. 1597 contains a provision that would subject all Internet wagers to the Federal wagering tax imposed under Section 4401 and that these wagers be classified as "state authorized wagers" under the bill. Table 5 shows our estimate of the revenue effect if the wagering tax were not applied. We arrive at this figure by applying our estimate that approximately 20.7 percent of the additional revenue collected under is attributable to this tax.

Table 5. – Estimated Revenue Effect of S. 1597 Assuming the Wagering Tax Imposed by Section 4401 Does Not Apply.

	Fiscal Years 2010 to 2019 (Millions of Dollars)			
	High Opt-Out	Medium Opt-Out	Low Opt-Out	All States
Estimated Revenue Effect of S. 1597 Assuming the Wagering Tax Imposed Under Section 4401 Does Not Apply	4,651.6	11,029.1	14,866.0	19,417.5

Source: *Quantria Strategies, LLC*

State Revenue Effects

States that do not opt-out of the new regulatory regime under S. 1597 will see increased revenues from two sources: (1) the parallel 5 percent license fee that will be distributed to each state and (2) increased income taxes from individuals and corporations. We summarize these effects in Table 6.

Our estimates of the potential additional state revenue that would be realized ranges from $2.4 billion to $8.4 billion under each of our scenarios. In arriving at these figures, we assumed that each state would receive the license fee directly from the Federally-administered Trust Fund in a proportion to each states' personal income share. (Our aggregate estimate of this license fee is outlined in Appendix 3.) We calculated our estimates of additional income tax receipts by adjusting each states' personal income share by an adjustment factor that reflects the top marginal individual income tax rate in those states that impose an income tax. We calculate this adjustment factor as the ratio of each states' top marginal rate to a weighted average computed for all fifty states.

Table 6. – Estimated Additional State Revenues from S. 1597 Under Alternative Assumptions (Millions of Dollars)

State	State Revenue Effects			
	High Opt-Out	Medium Opt-Out	Low Opt-Out	All States
Alabama	0.0	0.0	0.0	105.5
Alaska	0.0	15.1	15.1	15.1
Arizona	0.0	146.1	146.1	146.1
Arkansas	0.0	0.0	0.0	68.4
California	0.0	1,312.7	1,312.7	1,312.7
Colorado	139.6	139.6	139.6	139.6
Connecticut	0.0	132.1	132.1	132.1
Delaware	24.9	24.9	24.9	24.9
District of Columbia	0.0	0.0	0.0	30.9
Florida	0.0	358.5	358.5	358.5
Georgia	0.0	0.0	0.0	238.2
Hawaii	0.0	0.0	0.0	42.4
Idaho	0.0	0.0	0.0	38.6
Illinois	418.9	418.9	418.9	418.9
Indiana	132.7	132.7	132.7	132.7
Iowa	90.7	90.7	90.7	90.7
Kansas	0.0	0.0	78.3	78.3
Kentucky	0.0	0.0	0.0	96.5
Louisiana	113.2	113.2	113.2	113.2
Maine	0.0	0.0	0.0	38.0
Maryland	0.0	0.0	187.4	187.4
Massachusetts	0.0	0.0	226.7	226.7
Michigan	226.5	226.5	226.5	226.5
Minnesota	0.0	0.0	0.0	172.6
Mississippi	59.9	59.9	59.9	59.9
Missouri	152.6	152.6	152.6	152.6

(Continued)

Table 6. – Estimated Additional State Revenues from S. 1597 Under Alternative Assumptions (Millions of Dollars - Continued)

State	State Revenue Effects			
	High Opt-Out	Medium Opt-Out	Low Opt-Out	All States
Montana	0.0	24.7	24.7	24.7
Nebraska	0.0	0.0	51.2	51.2
Nevada	53.3	53.3	53.3	53.3
New Hampshire	0.0	0.0	0.0	28.6
New Jersey	359.9	359.9	359.9	359.9
New Mexico	0.0	45.1	45.1	45.1
New York	0.0	697.4	697.4	697.4
North Carolina	0.0	0.0	0.0	249.3
North Dakota	0.0	0.0	0.0	17.6
Ohio	295.0	0.0	0.0	295.0
Oklahoma	0.0	90.1	90.1	90.1
Oregon	0.0	111.2	111.2	111.2
Pennsylvania	301.7	0.0	301.7	301.7
Rhode Island	0.0	34.7	34.7	34.7
South Carolina	0.0	0.0	0.0	108.2
South Dakota	15.5	15.5	15.5	15.5
Tennessee	0.0	0.0	0.0	108.3
Texas	0.0	0.0	457.7	457.7
Utah	0.0	0.0	0.0	58.6
Vermont	0.0	0.0	0.0	19.8
Virginia	0.0	0.0	0.0	239.2
Washington	0.0	139.8	139.8	139.8
West Virginia	0.0	0.0	0.0	41.4
Wisconsin	0.0	0.0	155.3	155.3
Wyoming	0.0	0.0	0.0	12.9
Total, All States	2,384.2	4,894.9	6,353.2	8,363.1

VI. Conclusions

Our analysis suggests that limiting legalized Internet gambling to poker and other games of skill would still raise substantial amounts of revenue for the Federal government over the next 10 years: approximately $13.9 billion under a 5 percent license fee structure and under reasonable assumptions relating to states' decisions to not opt-out. If additional, neighboring states elect to not opt-out under this scenario, we estimate that the increase in Federal budget receipts would be approximately $18.7 billion. If all states elect to not opt-out under the new regulatory framework, we estimate $24.5 billion in additional Federal revenues would be realized.

State governments that elect to allow Internet poker and other games of skill to operate within their borders would also benefit financially. We estimate that state treasuries would see additional revenues from between $2.4 billion to $8.4 billion depending on how many states elect to not opt-out.

We arrive at these figures by adjusting official JCT revenue estimates of legislation that legalizes all Internet gambling to reflect important behavioral responses. Most importantly, we believe that many more states would not opt-out of the new regulatory regime if limited to Internet poker only.

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Appendix A – Summary of State Gambling Regulations

State	State Regulation of Gambling				
	Licensed Casino/Table Gambling	Tribal Gaming	Licensed Poker	Social or Charitable Poker	Skill Games
Alabama	No	Yes	No	Yes	Yes
Alaska	No	Yes	Yes	Yes	Yes
Arizona	No	Yes	Yes	Yes	Yes
Arkansas	No	No	No	No	No
California	No	Yes	Yes	Yes	Yes
Colorado	Yes	Yes	Yes	Yes	Yes
Connecticut	No	Yes	Yes	Yes	Yes
Delaware	Yes	No	Yes	Yes	Yes
District of Columbia	No	No	No	Yes	Yes
Florida	No	Yes	Yes	Yes	Yes
Georgia	No	No	No	No	Yes
Hawaii	No	No	No	Yes	Yes
Idaho	No	Yes	No	No	Yes
Illinois	Yes	No	Yes	No	No
Indiana	Yes	No	Yes	No	Yes
Iowa	Yes	Yes	Yes	Yes	Yes
Kansas	No	Yes	No	No	Yes
Kentucky	No	No	No	Yes	Yes
Louisiana	Yes	Yes	Yes	Yes	No
Maine	No	No	No	Yes	Yes
Maryland	No	No	No	Yes	No
Massachusetts	No	No	No	Yes	Yes
Michigan	Yes	Yes	Yes	Yes	Yes
Minnesota	No	Yes	No	Yes	Yes
Mississippi	Yes	Yes	Yes	Yes	Yes
Missouri	Yes	No	Yes	No	Yes

(Continued)

Appendix A – Summary of State Gambling Regulations (Continued)

State	State Regulation of Gambling				
	Licensed Casino/Table Gambling	Tribal Gaming	Licensed Poker	Social or Charitable Poker	Skill Games
Montana	No	Yes	Yes	Yes	Yes
Nebraska	No	Yes	No	No	Yes
Nevada	Yes	Yes	Yes	Yes	Yes
New Hampshire	No	No	No	Yes	Yes
New Jersey	Yes	No	Yes	Yes	Yes
New Mexico	No	Yes	Yes	No	Yes
New York	No	Yes	Yes	Yes	Yes
North Carolina	No	Yes	No	No	No
North Dakota	No	Yes	No	Yes	Yes
Ohio	Yes	No	No	Yes	Yes
Oklahoma	No	Yes	Yes	Yes	Yes
Oregon	No	Yes	Yes	Yes	Yes
Pennsylvania	Yes	No	No	No	Yes
Rhode Island	No	No	Yes	No	Yes
South Carolina	No	No	No	No	Yes
South Dakota	Yes	Yes	Yes	No	Yes
Tennessee	No	No	No	No	No
Texas	No	Yes	No	Yes	Yes
Utah	No	No	No	No	No
Vermont	No	No	No	Yes	Yes
Virginia	No	No	No	Yes	Yes
Washington	No	Yes	Yes	Yes	Yes
West Virginia	No	No	No	No	Yes
Wisconsin	No	Yes	No	No	Yes
Wyoming	No	Yes	No	Yes	Yes

Source: *Interactive Gaming Council*

Appendix B – State Personal Income and Marginal Tax Rates

State	State Economic Summary			
	2008 Personal Income (Thousands of Dollars) [1/]	Personal Income Shares	Top Marginal Individual Income Tax Rate [2/]	Adjusted State Income Shares [3/]
Alabama	157,421,997	1.3%	5.0%	1.2%
Alaska	30,223,608	0.2%	-	0.0%
Arizona	223,184,451	1.8%	4.5%	1.5%
Arkansas	92,505,191	0.8%	7.0%	1.0%
California	1,604,112,764	13.1%	9.3%	22.6%
Colorado	212,320,185	1.7%	4.6%	1.5%
Connecticut	197,023,620	1.6%	5.0%	1.5%
Delaware	35,376,923	0.3%	6.0%	0.3%
District of Columbia	39,131,118	0.3%	8.5%	0.5%
Florida	719,707,709	5.9%	-	0.0%
Georgia	337,960,830	2.8%	6.0%	3.1%
Hawaii	54,175,210	0.4%	8.3%	0.7%
Idaho	50,398,859	0.4%	7.8%	0.6%
Illinois	546,344,259	4.5%	7.8%	6.5%
Indiana	220,670,002	1.8%	3.0%	1.0%
Iowa	112,302,300	0.9%	9.0%	1.5%
Kansas	108,778,736	0.9%	6.5%	1.1%
Kentucky	136,939,777	1.1%	6.0%	1.2%
Louisiana	160,658,930	1.3%	6.0%	1.5%
Maine	47,994,130	0.4%	8.5%	0.6%
Maryland	272,542,169	2.2%	5.5%	2.3%
Massachusetts	333,046,494	2.7%	5.3%	2.7%
Michigan	349,612,178	2.9%	4.4%	2.3%
Minnesota	224,670,738	1.8%	7.9%	2.7%
Mississippi	89,331,219	0.7%	5.0%	0.7%
Missouri	216,546,820	1.8%	6.0%	2.0%

(Continued)

Appendix B – State Personal Income and Marginal Tax Rates (Continued)

State	State Economic Summary: 2008 Personal Income (Thousands of Dollars) [1/]	Personal Income Shares	Top Marginal Individual Income Tax Rate [2/]	Adjusted State Income Shares [3/]
Montana	33,515,577	0.3%	6.9%	0.4%
Nebraska	69,820,901	0.6%	6.8%	0.7%
Nevada	107,079,263	0.9%	-	0.0%
New Hampshire	57,399,130	0.5%	0.0%	0.0%
New Jersey	445,928,224	3.6%	9.0%	6.1%
New Mexico	66,336,940	0.5%	5.3%	0.5%
New York	950,209,504	7.8%	6.9%	9.9%
North Carolina	325,953,820	2.7%	7.8%	3.8%
North Dakota	25,575,905	0.2%	5.5%	0.2%
Ohio	413,732,085	3.4%	6.2%	3.9%
Oklahoma	131,070,218	1.1%	5.5%	1.1%
Oregon	137,569,686	1.1%	9.0%	1.9%
Pennsylvania	499,669,401	4.1%	3.1%	2.3%
Rhode Island	43,468,678	0.4%	8.8%	0.6%
South Carolina	146,334,933	1.2%	7.0%	1.6%
South Dakota	31,090,547	0.3%	-	0.0%
Tennessee	217,372,834	1.8%	-	0.0%
Texas	918,921,246	7.5%	-	0.0%
Utah	87,411,357	0.7%	5.0%	0.7%
Vermont	24,034,394	0.2%	9.5%	0.3%
Virginia	343,580,294	2.8%	5.8%	3.0%
Washington	280,677,561	2.3%	-	0.0%
West Virginia	57,410,905	0.5%	6.5%	0.6%
Wisconsin	212,553,339	1.7%	6.8%	2.2%
Wyoming	25,892,041	0.2%	-	0.0%

[1/] Source: Regional Economic Information System, Bureau of Economic Analysis, U.S. Department of Commerc

[2/] Source: *Federation of Tax Administrators*. Figures are for tax year 2008. New Hampshire and Tennesee limit taxes to interest and dividend income only.

[3/] State personal income shares are adjusted to reflect the ratio of each state's top marginal rate to the average (weighted) average top rate for all 50 states.

Appendix C – Background Data and Description of the Methodology

Our baseline calculations yield a similar result to that obtained by the JCT. There are several components to this estimate including: revenues raised from the licensing fee, wagering tax, individual income taxes, and corporate income taxes. In addition, there are several behavioral effects that could influence the magnitude of these estimates.

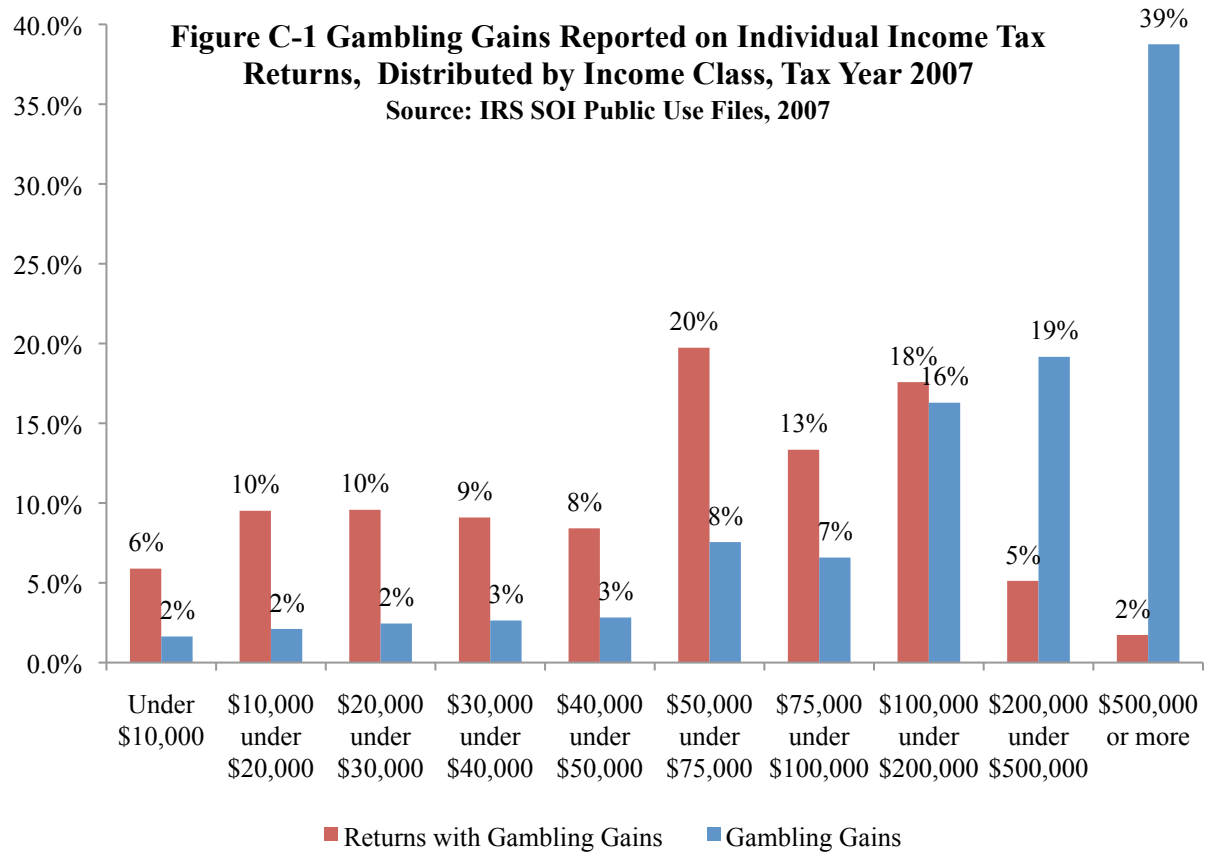
Licensing Fee – The licensing fee relies on figures in Table 3. We apply the 2 percent licensing fee to non-sports betting over the 2010-2019 period.

This result is subject to a 25 percent Federal income tax offset. Generally, excise taxes and other types of indirect taxes reduce income for individuals and businesses. Consequently, revenue derived from such existing direct taxes such as individual and corporate income taxes will also be reduced. To approximate this revenue decrease, the CBO, JCT, and the Treasury Department's Office of Tax Analysis (OTA) apply a 25 percent offset when estimating the net revenue expected from imposing the indirect tax. In other words, the estimated proceeds from the indirect tax are reduced by 25 percent to account for the resulting reductions in income and payroll taxes. The offset is made in addition to accounting for behavioral responses to the new tax.

Wagering Tax – To this we add the 0.25 percent wagering tax on gross revenues.

Individual Income Taxes – To arrive at the Individual Income tax component, we assume that 16 percent of net winnings represent winnings not presently captured by our tax system and apply an average marginal tax rate of 27.2 percent. The following graph displays gambling winnings for 2007 distributed by income class. As shown, gambling earnings are correlated positively with income. As a result the average marginal tax rate for Internet poker is likely to be somewhat above average compared to the overall (average marginal) rate for all taxpayers.

This tax rate relies on calculations from the Quantria Strategies Individual Income Tax Microsimulation model. The model examines changes in "Other Income", the component of Federal Adjusted Gross Income where gambling winnings are reported.



Corporate Taxes **–** To arrive at an estimate of additional corporate income taxes, we assume that the net yield of Internet operators, after adjustments to arrive at taxable income, are taxed at the current maximum corporate tax rate of 35 percent. In addition, we adjust this figure to take into account the revenue estimating convention that GDP must remain constant throughout the estimating horizon.

Taken together, these calculations yield an estimate of $37,836.0 million.

Behavioral Response **–** We adjust the above figures to reflect certain behavioral responses that we believe will occur should S. 1597 become law. These responses include:

> *An increase in the number of states not opting out if only Internet poker was legalized.*
>
> There are a number of factors that will influence the state's response to legalizing Internet poker. One such factor is the current fiscal crisis facing many states. Internet poker represents a new revenue source – one that does not carry negative associations. In other words, collecting revenue from online wagering does not appear to impose unfairly burdens on lower income taxpayers.

Another factor influencing the states' response may include the leader versus follower role. Those states that lead, i.e., move quickly to establish Internet poker sites, may have the ability to gain market share over those states that follow. Early adopters will have the benefits of establishing a presence in the market.

An increase in the amounts wagered on other "games of skill" that would qualify under the bill.

A small substitution effect of non-poker Internet gambling to legalized poker.

The above two responses will depend heavily on the visibility of poker generally and advertising for online poker specifically. One measure of the potential visibility is the presence of poker programs currently aired.

Table C1 provides a summary of the current poker programs and championships and the years that these programs aired. As shown, there have been 10 new poker programs since 2003. Of the 13 programs, 10 are aired currently.

The current programs airing offer two measures of the visibility of poker and online poker. First, the increase in the number of programs suggests a growing interest in poker – an interest that continues to remain strong. Second, given the number of programs aired, this provides a venue for advertising of online poker sites.[24]

Table C-1. – Televised Programs, Network and Years Aired

Program	Network	Years Aired
World Series of Poker	CBS;	1978-1981, 1983;
	ESPN	1987 onwards†
United States Poker Championship	ESPN	1997-2000;
		2003 onwards
World Poker Tour	The Travel Channel;	2003-2007;
	GSN	2008 onwards
Celebrity Poker Showdown	Bravo	2003 onwards
Poker Superstars Invitational Tournament	Fox Sports Net	2004 onwards
Ultimate Poker Challenge	syndication	2004 onwards
Poker Royale	GSN	2004-2006
High Stakes Poker	GSN	2006 onwards
Professional Poker Tour	The Travel Channel	2006 onwards

[24] 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 United States alone.

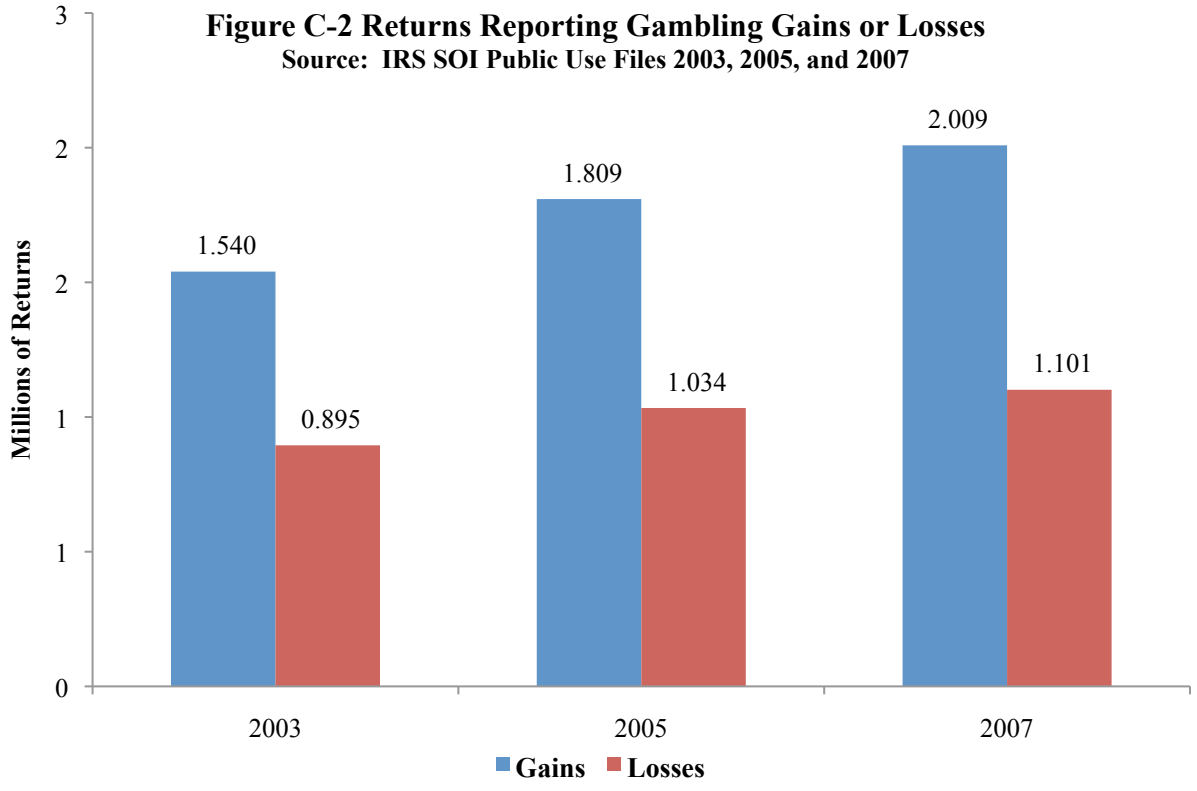
Table C-1. – Televised Programs, Network and Years Aired

Program	Network	Years Aired
National Heads-Up Poker Championship	NBC	2005 onwards
Poker Dome Challenge	Fox Sports Net	2006
Poker After Dark	NBC	2007 onwards
Pro-Am Poker Equalizer	ESPN	2007

†ESPN did not air the WSOP in 1996 or 1999-2001; The Discovery Channel did air one-hour specials of the 2000 and 2001 Main Events.

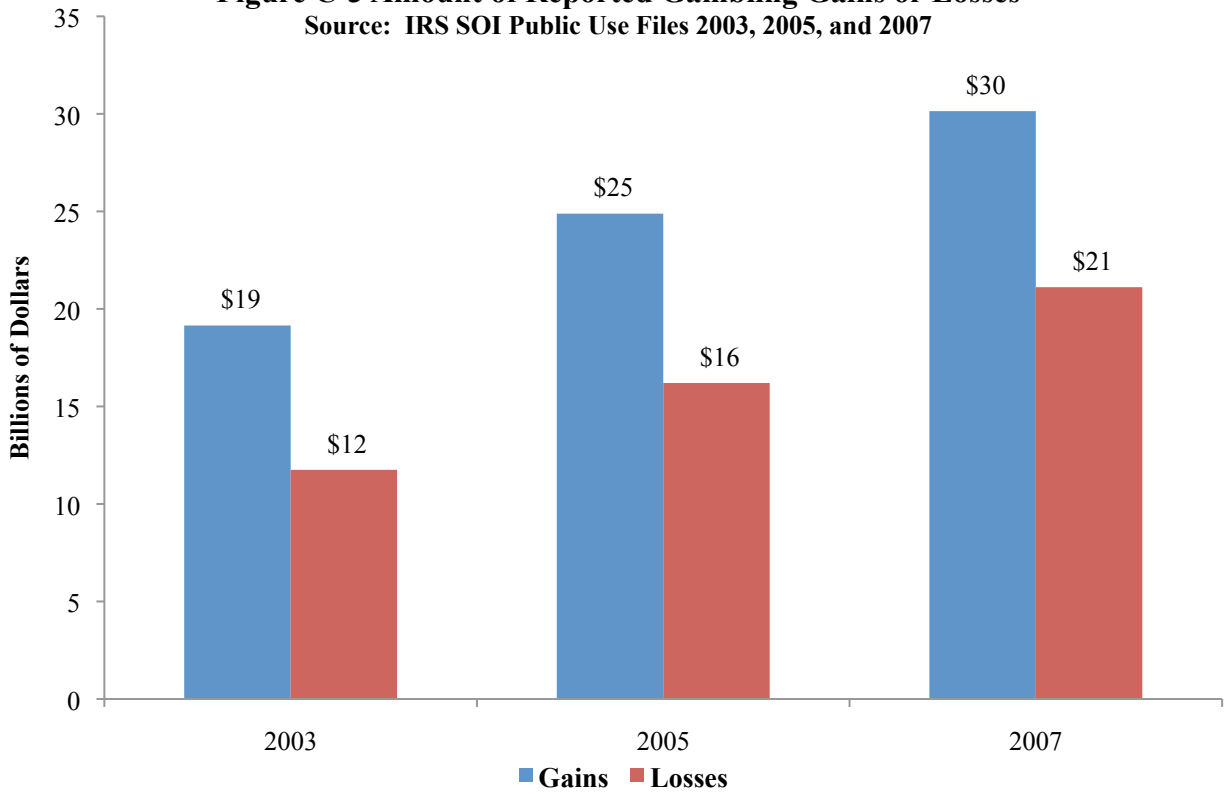
In addition to the potential incentives of poker visibility, gambling activities generally continue to grow. The following graphs present the number of individual income tax returns reporting gambling gains and losses. Figure C2 shows that the number of returns reporting gambling gains increased from 1.5 to 2.0 million returns (30 percent increase) from 2003 to 2007. Likewise, the number of returns reporting gambling losses increased from 895,000 to 1.1 million (23 percent increase) from 2003 to 2007.

Figure C-2 Returns Reporting Gambling Gains or Losses
Source: IRS SOI Public Use Files 2003, 2005, and 2007



Similarly, we observe a significant increase in the amounts reported for gambling gains and losses over the same period. Figure C3 shows that the amount of gambling gains increased from $19 to $30 billion (58 percent increase) from 2003 to 2007. Likewise, the amount of gambling losses increased from $12 to $21 billion (75 percent increase) from 2003 to 2007.[25]

Figure C-3 Amount of Reported Gambling Gains or Losses
Source: IRS SOI Public Use Files 2003, 2005, and 2007



The current IRS SOI data demonstrates the strong growth in the number of returns reporting gambling activity. However, while the numbers demonstrate strong growth, the amounts wagered are growing at a much more significant pace.

This information suggests that the substitution effect of non-poker Internet gambling to legalized poker has the potential to generate significant revenue through this substitution. In other words a small response, depending upon the taxpayers that substitute non-poker gaming to legalized poker, may generate significant revenues.

[25] The amount of gambling losses reported on individual income tax returns is limited under current law.