# worldonline gamblinglawreport

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# What opportunities exist in the US for non-US operators

As the internet gambling industry waits to see if the US Congress or a populous US State will pass legislation instituting a licensure and regulatory system for internet gambling, there is much discussion about what opportunities this will offer for non-US operators. Linda Shorey, Robert A. Lawton and Anthony R. Holtzman, of K&L Gates, look at two areas of concern that may impact the availability or the desirability of those business opportunities.

## The suitability conundrum

One way to approach this question is to look at how three categories of non-US operators might fare under proposed federal legislation. First are operators that do not, and never did, accept wagers from US-based players (Category 1).

Second are those that do not, but prior to 2006 (when the Unlawful Internet Gambling Enforcement Act - UIGEA - came into force) did accept wagers from US-based players (Category 2). Within this category are two sub-groups - those that have and those that have not reached an agreement with the US Department of Justice (DOJ). Third are those that accept wagers from US-based players (Category 3). Within this category are also two subgroups - those that accept non-sports wagers and those that accept sports wagers.

The Bills in the US Congress that are receiving the most attention are HR 2276 ('the Frank Bill') - introduced in the House of Representatives by Representative Barney Frank - and S1597 ('the Menendez Bill') introduced in the Senate by Senator Robert Menendez. These Bills have similar suitability requirements but somewhat different unsuitability provisions.

Both Bills would require applicants, to be considered suitable, to show 'by clear and convincing evidence' that they - and certain associates - meet requirements such as:

- They do not have 'prior activities, reputation, habits, and associations' that (a) 'pose a threat to the public interest or to effective regulation and control of the licensed activities' or (b) 'create or enhance the dangers of unsuitable, unfair, or illegal practices, methods, and activities in the conduct' of licensed activities or business and financial arrangements incidental to their activities.
- They are 'capable of and likely to conduct' business in conformity with the subchapter that would be added to US law if one of the Bills were to be enacted and with any regulations prescribed under that sub-chapter.

Demonstrating these requirements could prove difficult for any non-US operator, regardless of the category, that has encountered problems elsewhere in the world. For example, operators - regardless of the category - that have had employees arrested in Turkey, have ignored requests by law enforcement officials anywhere in the world to cease and desist from certain activities, or have accepted wagers from players in countries that require licensing without obtaining a license may find it difficult to meet either requirement. The requirements may also create problems for Category 2 and 3 operators. A Category 2 operator (accepted wagers pre-UIGEA) that has reached an agreement with the DOJ can argue that its agreement shows it would be a 'good corporate citizen' if licensed.

Both Bills also contain provisions concerning unsuitability. Under the Frank Bill, an applicant would be deemed unsuitable for licensure if, among other factors:

- It failed to certify that it and any affiliated business entity, (a) has not 'committed an intentional felony violation of Federal or State gambling laws' and (b) used 'due diligence to prevent any US person from placing a bet on an internet site in violation of Federal or State gambling laws'.
- Since the UIGEA's enactment, it (a) 'knowingly' participated in or should have known it was participating in illegal internet gambling or been owned, operated, managed, or employed by someone conducting illegal internet gambling; or (2) received assistance (financial or otherwise) from a person who 'knowingly' accepted bets or wagers from a person located in the US in violation of Federal or State law.

Under the Menendez Bill, an applicant would be deemed unsuitable if, among others things, it 'knowingly accepts, or knowingly has accepted, bets or wagers on sporting events from persons located in the United States in violation of applicable Federal or State law'.

It is unclear what a regulator would consider to amount to 'knowingly' or 'intentional' conduct with respect to wagering on activities other than US sports. It has been reported that at least one Category 3 operator (one that accepts wagers from US-based players) that offers real money poker games on the internet is relying on legal advice that such activity is legal and, therefore, believes it cannot be considered to have 'knowingly' or 'intentionally' violated any Federal or US State gambling laws. How receptive regulators will be to that argument is difficult to predict.

Category 1 operators (ones that have never accepted wagers from US players) should not have to worry about these unsuitability

provisions. However, Category 2 operators, because they did at some point accept wagers from US players, may experience some difficulty with the first unsuitability provision of the Frank Bill noted above, which does not have a time cutoff. Those with DOJ agreements may be experiencing some angst about having admitted to violating certain US Federal criminal laws, including the Illegal Gambling Business Act that requires a violation of US State law as a predicate.

## The fees/taxes imposed

One primary driver behind legislative efforts in the US (federal and state) to authorise, license, and regulate internet gambling is the possibility of a new revenue source for government.

One revenue stream is expected from taxes that would be paid by US players from their winnings. US-licensed operators would, at a minimum, have to report gambling winnings and withhold 25% in estimated federal taxes from any player winning, generally, over $600. For poker tournaments, the reporting and withholding requirements would be invoked at $5,000 in winnings.

The Congressional Budget Office (CBO) Report released in connection with the Frank Bill estimates that, if enacted, the taxes collected from players would not only cover the cost to launch and operate the licensure and regulatory program proposed by the Frank Bill but also result in a net return of $283 million. While the Frank Bill would not impose any fees or taxes on operators licensed pursuant to its terms, there is another House Bill - HR 4976, introduced by Representative Jim McDermott - that proposes a taxing scheme on operators licensed under the subchapter the Frank Bill would put in place. It would impose a 2% federal fee and a 6% state/tribal fee on all deposits made by players into their accounts with a licensed internet gambling operator.

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The Menendez Bill is similar. It would impose a federal fee of 5% on all deposited funds, as well as a state/tribal fee of 5%. Under both Bills, 'deposited funds' would not reflect churning (i.e. winnings or losses that move into and out of accounts) and the state/tribal fee would be payable to the state or tribe where the player is at the time of the deposit. The 'fee-on-deposits' scheme is not how US land-based gambling entities are taxed. US States typically tax land-based casinos based on 'gross gaming revenue', which can be characterised as the difference between a casino's gaming wins and losses before any costs and expenses are deducted. The schemes proposed in the McDermott and Menendez Bills appear likely to result in a more burdensome tax scheme than that imposed on any land-based gambling business

More and more jurisdictions around the world are choosing to license and tax internet gambling operators. Some operators may choose not to seek licensure in a jurisdiction if they perceive the tax rate too burdensome, as is being seen with France. Even if non-US operators believe a US federal license would permit the generation of sufficient business to pay the federal fee on deposits, the same belief may not exist in connection with a State license, even with a tax on gross gaming revenue, given that the pool of potential participants would be smaller and the cost to operate potentially higher.

In sum, if the US Congress or a US state enacts legislation to authorize and regulate internet wagering, whether non-US operators will actually have viable opportunities in the US remains unknown.

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