

2022

Gambling or Skill: Taxation Issues Surrounding the Daily Fantasy Sports Industry

Keith Lowe

Jacksonville State University, klowe@jsu.edu

Benjamin B. Boozer Jr.

Jacksonville State University, bboozer@jsu.edu

Follow this and additional works at: <https://digitalcommons.subr.edu/cbej>



Part of the [Business Administration, Management, and Operations Commons](#), [Business and Corporate Communications Commons](#), and the [E-Commerce Commons](#)

Recommended Citation

Lowe, Keith and Boozer, Benjamin B. Jr. (2022) "Gambling or Skill: Taxation Issues Surrounding the Daily Fantasy Sports Industry," *Southern University College of Business E-Journal*: Vol. 16: Iss. 2, Article 2. Available at: <https://digitalcommons.subr.edu/cbej/vol16/iss2/2>

This Article is brought to you for free and open access by the College of Business at Digital Commons @ Southern University and A&M College. It has been accepted for inclusion in Southern University College of Business E-Journal by an authorized editor of Digital Commons @ Southern University and A&M College. For more information, please contact maletta_payne@subr.edu.

Gambling or Skill: Taxation Issues Surrounding the Daily Fantasy Sports Industry

S. Keith Lowe

Professor of Business Statistics
Department of Finance, Economics, & Accounting
School of Business & Industry
Jacksonville State University
Jacksonville, AL 36265
klowe@jsu.edu

Benjamin B. Boozer, Jr.

Associate Professor of Finance
Department of Finance, Economics, & Accounting
School of Business & Industry
Jacksonville State University
Jacksonville, AL 36265
bboozer@jsu.edu

ABSTRACT

With a waxing interest in sporting events, participants are increasingly supplementing passive viewing with a more active role. Fantasy sports leagues have burgeoned as a result, with corresponding increases in live game attendance and media consumption across platforms. Fantasy bettors seek financial gain through the ability of athletes and the likelihood of their team performing well in a sporting event. A major legislative concern within this industry is whether these activities are considered gambling, with its related stigma, or otherwise just a type of sporting activity. More importantly, gambling has a long history as a major source of tax revenue within its lineage.

This paper examines these current public policy and taxation issues that will shape the future landscape of fantasy sports. Various legislation has defined type and scope of betting that have been gradually modified to permit a larger role for individual states to develop policies. A majority of states have adopted tests that apply the degree of chance versus skill in a contest. As of 2020, sports betting has been declared legal and is presently providing tax revenue in 23 states plus Washington, D.C. Higher levels of chance are generally deemed an illegal activity, using the 10th Amendment to the U.S. Constitution as a basis. Recent IRS opinions (July 2020) find that daily fantasy sports operators are liable for two federal excise taxes and must identify themselves by registering as a business accepting wagers.

Lower gaming taxes are associated with a proliferation of legal sports betting. For this paper each of the following three properties must be present to be considered gambling: consideration, prize, and chance. States have authority in defining gambling activities, with Congress regulating commerce among states. Substantial opportunity exists in taxing online betting as a source of revenue or placing excise taxes on gambling as a method to control consumer

behavior. To the extent that federal and state governments continue debating legalized betting activities and the related taxes generated, consumer protection must focus on continued legitimacy of the environment and address addiction risk as a basis for further growth.

Keywords: Fantasy sports, gambling, sports betting, taxation.

Introduction

Sporting events have become an integral component of worldwide culture and impact billions of people worldwide. Recent viewership statistics of major team sporting events illuminates its popularity, with the 2015 Super Bowl achieving the largest audience in television history with approximately 115 million viewers (Pallotta, 2017) and the 2014 World Cup generating \$527 billion in revenue (Manfred, 2015). In addition to simply being spectators of a respective sporting event, many viewers choose to take a more active role in the outcome of various sporting events by participating in fantasy sport leagues. A study by Nesbit and King (2010) indicated that fantasy sport participation was shown not only to increase live game attendance but also sports media viewership. Research further shows that fantasy sports consumption enhances the level of media consumption across various platforms, including Twitter, YouTube, and Facebook (Chan-Olmstead & Kwak, 2020; Chan-Olmstead & Wolter, 2018).

The overriding goal of most fantasy bettors is to make player personnel decisions that will result in the generation of financial gain. Participants attempt to gain a competitive advantage by researching certain athletes' ability and resulting likelihood of their team performing well in a given sporting event. Many participants also invest additional funds into decision-making tools. Collectively, these participants spend more than \$250 million annually on additional websites, computer software, fantasy sports periodicals, and related decision-making resources (Peterson, 2019). Additionally, many scholarly articles have been published on an athlete's fantasy

performance (Becker & Sun, 2016; Boyd, 2014; Ware & Webb, 2008) and mathematical models that optimize a fantasy team selection process (Bonomo, Duran, & Marenco, 2014; Belien, Goosens, & Van Reeth, 2017; Newell & Easton, 2017).

Recent implications that all fantasy sports should be considered gambling has caused a major disruption in the industry. As lawmakers, courts, and companies alike have struggled in this realm of uncertainty, the question of what constitutes gambling has become a central focus. The true definition of gambling is often masked in a myriad of laws which vary from state to state or even by several feet. For example, a casino can be legally located in the middle of a river that separates two states but relocating that facility to either of the two shores makes the casino an illegal enterprise (Easton & Newell, 2019).

One of the primary reasons the fantasy sports industry has marketed their products and services as non-gambling endeavors is to avoid the related stigma of gambling, which can not only lead to a negative public perspective but these activities are also subject to taxation at the federal and state levels in most situations. Casinos and related sportsbooks in Nevada and a few other states have been responsible for remitting gambling-related taxes for decades. These taxes are assessed not only for traditional casino games but also sports-related wagers. Recent changes in federal statutes, including U.S. Supreme Court verdicts and Internal Revenue Source (IRS) opinions, have put the tax-free status of all fantasy sports in peril. This paper examines these current public policy and taxation issues that will shape the future landscape of fantasy sports.

History of Fantasy Sports

While the exact lineage of fantasy sports is often disputed, the earliest example of sports-based gaming occurred in the 1920s in connection with a board game named All-Star Baseball created by the Ethan Allen Company (Edelman, 2011). The earliest fantasy football league is widely regarded as the Greater Oakland Pigskin Prognosticators League, formed in the 1960s by a group of gambling-oriented friends (Hruby, 2013). In 1961 Bill Gamson, a psychology professor at the University of Michigan with a research interest in the statistical elements of baseball, began offering a game called the “Baseball Seminar.” Entrants into this seminar paid a \$10 entry fee for the opportunity to select players who would be evaluated based on their performance over an entire Major League Baseball (MLB) season (Edelman, 2011). One of Gamson’s students (Daniel Okrent) is often cited as the inventor of fantasy baseball through his creation of a similar format known as the Rotisserie League of Baseball (Lipsyte, 1996).

A monumental change occurred in the fantasy sports industry with the proliferation of Internet access. By 2010, fantasy sports had expanded beyond small circles of friends meeting to draft teams to an estimated 30 million Americans participating in some form of fantasy sports. A complementary industry of supporting materials such as draft guides and specialized computer software accompanied the rise of fantasy sports, yielding revenues of \$800 million annually (Hutchins & Rowe, 2012). However, the explosion of fantasy sports seemed to coincide with the passage of the Uniform Internet Gambling Enforcement Act (UIGEA), a federal banking statute that was attached as a rider to a port security bill in 2006. While the main purpose of the UIGEA was to criminalize electronic fund transfers related to gambling activities such as online poker, it achieved the dual purpose of creating an exemption for fantasy sports (Leonard, 2008).

Types of Fantasy Sports

Two primary versions of fantasy sports currently exist: season-long and daily. Under the parameters of a season-long fantasy league, participants draft individual players and compete over the course of an entire season, with most seasons spanning several months. In 2007, companies began offering a new form of fantasy sports that are played exclusively on-line called “daily fantasy sports” (DFS). DFS possesses many key differences from traditional, season-long fantasy games. For example, DFS events denote a single set of games, which typically last from a single day to a time period of a weekend and the participants tend to be a much larger group of unrelated participants. Rather than a draft, each DFS participant is given an equal amount of fictitious money known as a “salary cap.” Participants may select the same players for their fantasy teams as other participants as long as the selections do not exceed a participant’s salary cap. Furthermore, an individual who selected a poorly performing team in a specific DFS contest will have an opportunity to select an entirely different team for future events (Easton & Newell, 2019).

DFS contests are hosted on an operator’s website and are accessed by DFS participants via computer or another related device such as a tablet or smartphone. To initially participate in a contest on a DFS operator’s website, a participant must first register for an account. Many DFS operators offer various types of DFS contests on their websites, including “guaranteed prize pools,” in which participants pay a set entry fee to compete against large fields for a share of a fixed prize pool. For contests involving guaranteed prize pools, a typical DFS operator will set the prize pool such that it retains a commission ranging from 6 to 14%. When a participant enters a contest, the amount of the entry fee is debited from the participant’s segregated account. The DFS operator, upon debiting a participant’s segregated account, deposits the amount in its own account and records the amount as cash revenue on its books. Upon the completion of a contest, the DFS

operator deposits any contest winnings into the winning participants' segregated accounts and deducts those amounts from its own revenue for recordkeeping purposes (Van Natta, 2016).

Fantasy sports are extremely popular with approximately 60 million participants (Easton & Newell, 2019). Two companies, DraftKings and FanDuel, dominate the industry by collectively accounting for approximately 90% of total DFS transactions (Van Natta, 2016). According to Heitner (2015) the DFS industry is expected to continue its remarkable growth rates and produce \$15 billion in revenue by the end of 2020. A chronology of important events in the daily fantasy sports industry is listed in Table 1.

Table 1: Important Events (Daily Fantasy Sports)

Date	Milestone (Event)
October 2006	Unlawful Internet Gambling Enforcement Act (UIGEA) was signed into law, containing explicit language that legalized daily fantasy sports.
June 2007	Fantasy Sports Live launched, becoming the first DFS gaming site.
July 2009	FanDuel was founded, later becoming the largest DFS gaming site.
December 2010	FanDuel Fantasy Football Championship was held in Las Vegas, NV. First live final game event in DFS history.
January 2012	DraftKings was founded, later becoming the second largest DFS gaming site.
April 2013	MGT became the first publicly traded company to control a DFS site after it acquired FanThrowDown.
March 2014	DraftKings become an official sponsor of Major League Baseball (MLB).
August 2014	DraftKings raised \$41 million in funding in a Series C investment round.
September 2014	FanDuel raised \$70 million in funding in a Series D investment round.
November 2014	DraftKings become an official partner of National Hockey League (NHL).
November 2014	FanDuel become an official partner of National Basketball Association (NBA).
February 2015	DraftKings become an official partner of Ultimate Fighting Championship (UFC).

Impact of Federal Legislation on Fantasy Sports

Historically, several pieces of federal legislation had a notable impact on fantasy sports. First, the Interstate Wire Act of 1961 (the Wire Act) prohibited people from making bets or wagers over the telephone. Initially intended as a tool to combat organized crime and illegal gambling activities such as bookmaking, the scope of the statute addressed the current technology of that era. Although Internet and related online technology was nonexistent to the general public during that time period, the Wire Act was subsequently found to apply to Internet communications as well. In a 2011 opinion from the U.S. Department of Justice, it was concluded that the Wire Act only applied to sports betting; this opinion would remain the primary guidance on its scope for approximately seven years. In 2018, the Justice Department under the Trump administration rescinded the previous guidance and issued a new interpretation of the Wire Act's scope. The current interpretation determined that the Wire Act applies to a "variety" of gambling activities beyond sports wagering (Holden, 2020; Holden, McLeod & Edelman, 2020).

Several past court cases provide a relevant precedent in the case law to address the scope of how fantasy sports might be treated in future cases governed by the Wire Act. *United States v. Cohen* (2001) addressed an issue on a sports betting operation in Antigua that accepted wagers both over the telephone and via the internet. The Court concluded that even internet wagers passed through "wire facilities," thus invoking the statute. In *United States v. Lyons*, the defendants argued on an appeal that the Wire Act is inapplicable to the internet as that transmission medium is not a "wire communication facility." This defense was rejected by the First Circuit, noting that the statute has been attached to conduct over the internet, and that the internet involves a transmission "to and from customers" (*United States v. Lyons*, 2014).

The second widespread piece of legislation pertaining to fantasy sports was the 1993 Professional and Amateur Sports Protection Act (PASPA), which made wagering on sports generally illegal throughout the country. Commonly known as the “Bradley Act” this law exempted Nevada’s well-known sports wagering business, as well as the sports lotteries in Delaware, Montana and Oregon, because each were in operation prior to the legislation’s passage in 1993. However, a 2018 U.S. Supreme Court case (*Murphy v. National Collegiate Athletic Association*) overturned PASPA, paving the way for individual states to introduce legislation permitting sports betting (Lowe & Gilbert, 2020).

In theory, the Wire Act and PASPA could have prohibited fantasy sports, but fantasy games have never been challenged under either law. The Wire Act may not be applicable, since it applies only to “games of chance,” and to date fantasy sports have never been legally challenged and classified as such. Although now a moot point with a Supreme Court reversal, PASPA may not have been relevant either, because fantasy games generally have not been considered gambling. Many professional sports leagues host fantasy games on their league websites and promote their use on television and radio (Holden, 2020).

Finally, fantasy sports also could have been affected by the Uniform Internet Gambling Enforcement Act (UIGEA), which made it illegal to gamble over the Internet. UIGEA, however, includes a specific exemption for fantasy sports, known as a “carve out.” This “carve out” is applicable provided a specific fantasy sports activity meets three requirements:

1. The value of prizes is not dependent on the number of players
2. The outcome is determined by fantasy-player skill and knowledge, and is based on statistical results of real-world athletes

3. Winning outcomes cannot be determined by a point-spread or based solely on one individual player's performance

However, one caveat is noteworthy: these protections were carved out to support season-long fantasy contests, which were built into UIGEA before DFS sites existed. Most likely, lawmakers did not anticipate the creation of a product like DFS when certain fantasy games were exempted from the regulatory statutes of UIGEA. Former U.S. Representative Jim Leach, one of the co-sponsors of UIGEA in 2006, stated that “lawmakers had no idea daily fantasy sports would morph into today’s cauldron of daily betting” (Holden, McLeod & Edelman, 2020).

State-Based Regulations

As confusion has reigned whether daily fantasy sport contests are legal under federal statutes, individual states have taken various approaches to clarify the legality of these actions within a respective state’s border. Using the 10th Amendment to the U.S. Constitution addressing individual states’ rights as a basis, each of these approaches have eventually led to state-based legislation and statutes. Three tests have emerged that states apply to determine the legality of daily sports contests: the “predominant purpose” test, the “material element” test, and the “modicum chance” test (Edelman, 2016).

A majority of U.S. states have adopted some version of a “predominant purpose” test, in which a state considers whether a contest involved more skill than chance. If a greater amount of skill is present, the contest is deemed legal. A smaller number of states have implemented a form of the “material element test,” which considers whether an important element of the contest depends on an element of chance. If a material element does depend on chance, the contest would be classified as illegal. Finally, a small percentage of states have adopted a “modicum of chance

test.” If this test is applied and a contest contains any degree of chance, the respective contest is deemed illegal (Jessop, 2018).

Applying the test adopted by their respective state, some state legislatures have enacted statutes declaring the legal status of daily fantasy sports. As of the date of data collection for this study, 22 states have passed some form of legislation that led to a state statute or law governing or clarifying the operation of these activities within a state’s geographic boundaries. Table 2 contains information regarding each state’s legislation and the year of adoption.

Table 2: State-Based Legislation (Fantasy Sports)

State	Legislation	Year Enacted
Alabama	Fantasy Contests Act	2019
Arkansas	Fantasy Sports Games (Act 1075)	2017
Colorado	Fantasy Contests Act (Title 12, Article 125)	2019
Delaware	Delaware Interactive Fantasy Contest Act	2017
Indiana	Senate Enrolled Act 339-2016	2016
Iowa	ARC 4618C	2019
Kansas	Kansas Charitable Gaming Act	2015
Maine	Regulation of Fantasy Contests (PL, Chapter 303)	2017
Maryland	Daily Fantasy Sports Regulation (Maryland Attorney General’s Office)	2017
Massachusetts	Daily Fantasy Sports Contest Operators (940 CMR)	2016
Mississippi	Mississippi Gaming Commission (Title 13)	2018
Missouri	Missouri Gaming Commission (Chapter 40)	2020
Montana	Montana Code (Chapter 5, Part 8: Fantasy Sports)	2019
New Hampshire	Fantasy Sports Contests (Chapter 287-H)	2017
New Jersey	Fantasy Sports Operators (New Jersey Administrative Code: Title 13, Chapter 45A)	2019
New York	NY Gaming Commission: Interactive Fantasy Sports	2016
Ohio	Fantasy Contests (Chapter 3772-74-01)	2019
Pennsylvania	Fantasy Contests (48 Pa.B. 2559)	2018
Tennessee	Fantasy Sports Section (Division of Charitable Contributions)	2018
Vermont	Fantasy Sports Contests (Title 9, Chapter 116)	2018
Virginia	Fantasy Contests Act (Title 59.1)	2016
West Virginia	Lottery Sports Wagering Rule (Title 179, Series 9)	2018

Gambling-Related Excise Taxes

In 1954, Congress began imposing a 10% federal excise tax on all sports-related wagers, legal and illegal. Due to the relatively high percentage of this excise tax, it was extremely difficult for even the most skilled sports handicappers to achieve a profit. At that time, licensed sports books were limited only to the state of Nevada and these facilities were called “turf clubs.” These clubs were limited in number, smaller in size, and not affiliated with larger gambling establishments such as casinos. Individuals who worked in the industry during this time period often reported widespread tax evasion to circumvent this high rate of taxation. For example, an \$1,100 bet to win \$1,000 was often understated and recorded as merely \$11 to win \$10 (Jessop, 2018).

Historically, sports books have made their profit from the statistical advantage they have over their patrons. The most common wager is a multiple of \$11 to win \$10. If the sports book succeeds in having the same amount of money wagered on both sides of a sporting match, it is guaranteed to make a profit. For example, if Bettor A bets \$11 on their team and Bettor B bets \$11 on the opposing team, the sports book has collected a revenue of \$22. The sports book then pays the winner only \$21, which equates to the original \$11 bet back and \$10 in winnings. The sports book retains the additional \$1. The above scenario illuminates why the 10% tax would be devastating if it could not be passed on to the patrons. Of the \$22 bet in the example above, the federal government would take \$2.20 (much more than the sport book’s expected \$1 profit). But the 10% tax could not be passed on, because the patrons would no longer be betting \$11 to win \$10, but rather \$11 plus 10% (\$1.10) for a total of \$12.10 to win \$10.

In 1974, Congress lowered the federal excise tax on sports wagers to 2%. Using the same numbers for comparison purposes, a sports book with a handle of \$10 million, a hold of 4.16% producing a win of \$416,000 now only had to pay the federal government \$200,000. This is

equivalent to a tax on gross gaming revenue of 48.07%. Nevada also has a sliding scale of state gaming taxes, with the top tax rate quickly reaching 6.75% of gross gaming revenue. Therefore, the lowering of the federal excise tax to 2% allowed sports books in Nevada to operate more efficiently through paying a reduced rate. This was low enough to allow a few entrepreneurs to think about expanding the small turf clubs into true sports betting parlors. In 1975 the Nevada Legislature passed enabling legislation so that casinos could have sports books. But the tax rate was so high that few casinos were willing to devote any of their valuable floor space to a form of gambling that generated so little to the bottom line. In 1983, Congress lowered the federal excise tax on legal sports wagers to 0.25% (with illegal sports bets still paying 2%). A sports book with a handle of \$10,000,000, a hold of 4.16% producing a win of \$416,000 now only had to pay the federal government \$25,000 (0.25% times \$10,000,000). This is equivalent to a tax on gross gaming revenue of 6.01% (\$25,000 divided by \$416,000). Nevada's top tax rate of 6.75% means the sports books were now paying the equivalent of approximately 12.76% of gross gaming revenue (6.01% federal plus 6.75% state taxes).

The direct result of having gaming privilege taxes marginally below 13% of gross gaming revenue for legal sports books was an explosion of growth and capital expenditures for Nevada's sports betting industry. In 1973 there were only ten sports books with a total handle of \$2.8 million. Twenty years later there were approximately 100 sports books with a total handle in excess of \$2 billion. By the year 2000 the total number of sports books had grown to 157, with a total handle greater than \$2.5 billion, generating more than \$117 million in gross gaming revenue. Sports books not only became large and numerous in Nevada but they were viewed as profit centers and entertainment enticements for commercial casinos. By 1985 all of the small independent sports books were closed, replaced by multi-million dollar casino sports books with dozens of giant video

screens and all the other services desired by sports bettors, including easy access to other forms of gambling (Eason & Newell, 2019).

Recent IRS Opinions

While the entire DFS industry has spent years marketing themselves as a skill-based endeavor, that attempt could be in vain. In a recent internal memo released in July 2020, the Internal Revenue Service (IRS) has determined that daily fantasy sports (DFS) operators are liable for two federal excise taxes and must register as being “engaged in business of accepting wagers” (Internal Revenue Service, 2020). While not carrying the weight of tax law and ultimately enforcement, this memo clearly outlines the position of the IRS in future auditing procedures. The IRS generally imposes an excise tax on every sports betting wager, as well as an annual occupational tax on each sports betting operator. These taxes are nothing new for sportsbook operators, as Nevada-based operators have been responsible for paying them for years. Additionally, sportsbooks in states that have emerged since the 2018 *Murphy* decision are also subject to the excise tax (Lowe & Gilbert, 2020). However, the IRS’s application of these taxes to DFS was certainly a surprise to DFS operators, as DFS is considered in many jurisdictions to be a game of skill and therefore not gambling, and by extension, arguably not “wagering.”

In September 2020, a subsequent IRS private letter ruling (PLR) further clarified the issue on whether DFS constitutes gambling. In this ruling, a taxpayer-friendly position was taken to allow tax deductions of DFS entry fees. In concluding that DFS is indeed gambling the IRS relied on the “plain, obvious, and rational” definition of gambling as discussed in *Tschetschot v. Commissioner* (T.C. Memo 2007-38). In that decision, for purposes of applying Section 165(d), the Tax Court examined dictionary definitions of “wager”, including Random House College Dictionary’s definition of “something risked or staked on an uncertain event; bet;

the act of betting,” in ultimately holding a poker tournament is a wagering activity. Additionally, the Court also considered the following definition of “wager” from Black’s Law Dictionary: “Money or other consideration risked on an uncertain event; a bet or gamble; and a promise to pay money or other consideration on the occurrence of an uncertain event” (United States Tax Court, 2007).

The definition of gambling for this research paper is summarized by Rose and Owens (2009). All gambling activities must have three common properties: consideration, prize, and chance. Consideration occurs when an individual must decide to participate in an activity. Furthermore, the participant must offer an item of value. If any of these properties is absent, the activity is not considered gambling. For example, a no-purchase-necessary sweepstakes is not gambling due to a lack of consideration. A charity casino night has an entry fee and all proceeds go to the charity but it lacks a prize and is not considered gambling. Finally, entering a sporting event with an entry fee and a cash prize for first place is not gambling due to the specific skills needed to win.

Section 4421 of the Internal Revenue Code (IRC) defines a wager, in part, as “any wager with respect to a sports event or a contest placed with a person engaged in the business of accepting such wagers” or “any wager placed in a wagering pool with respect to a sports event or a contest, if such pool is conducted for profit.” The memorandum concludes that DFS entry fees are “wagers” under that term’s plain meaning, and that the DFS entry fee is a wager of money by a DFS user, with respect to sports events and contests, that is placed with a person engaged in the business of accepting such wagers (for example the DFS operator). Further, the memorandum states that the wagers are placed in a common fund with other users’ entry fees (e.g. a wagering pool) and that such pools are conducted for profit by the DFS operators.

While the memorandum acknowledges that the presence or absence of skill is relevant to whether the entry fee is a taxable wager or not, it asserts that DFS was not equivalent to other contests previously considered by the IRS that were based solely on skill, and noted that Sections 4401 and 4421 of the IRC do not consider whether an activity involves skill, chance or some combination of the two, and that whether DFS is a game of skill under a particular state's law is not relevant for evaluating whether DFS entry fees are a "wager" under Section 4421.

Accordingly, the memorandum concludes that as "wagers" under the IRC, DFS entry fees are subject to the excise tax that ranges from 0.25% of the amount of the wager on any wager authorized under the law of the state in which it is accepted, to 2% of the amount of any wager in regard to a wager that is unauthorized. It should be noted that this excise tax applies to total DFS entry fees as opposed to the DFS operator's revenue from conducting DFS contests. The memorandum also concludes that DFS operators are liable for annual occupational excise taxes ranging from \$50 to \$500, with \$50 applying to a DFS operator that only accepts state authorized wagers, and \$500 applying to a DFS operator accepting wagers in states where DFS is not authorized. DFS operators must also register with the IRS pursuant to Section 4412 of the IRC.

As noted, the excise tax percentage and occupational excise tax amount hinge on whether the relevant wagers are authorized under the law of the state in which they are accepted. Despite the memorandum acknowledging that the regulation of DFS varies across the country, with some states defining DFS as a game of skill or otherwise not gambling, others holding that DFS is illegal under state law and others taking no position at all on its legality, the memorandum does not address which wagers are considered authorized under state law and

which are not. The memorandum simply notes that if DFS is not authorized under state law and a DFS operator accepts a wager in such a state, the higher rate and annual fee would apply ((Internal Revenue Service, 2020).

Conclusion

Traditionally, states have exercised their authority to define gambling activities through their police powers. However, Congress has the power to address this matter through the Commerce Clause, which allows Congress to “regulate commerce among several states.” Per the Commerce Clause, Congress may regulate activities having a substantial relation to interstate commerce. As a multiple-billion dollar industry in many states, daily fantasy sports can be viewed as having a substantial effect on interstate commerce. In 2018, the U.S. Supreme Court overturned a federal law prohibiting sports betting (*Murphy v. National Collegiate Athletic Association*) allowing states to decide on the issue for themselves. As of 2020, sports betting has been declared legal and is presently providing tax revenue in 23 states plus Washington, D.C. However, it is noteworthy that only some of these states allow DFS, and not all states that allow DFS permit sports betting.

Taxing online fantasy sports and sports betting may assist individual states in recovering a substantial portion of the sales tax revenue lost during the coronavirus pandemic. According to Joyce Beebe, a fellow in public finance at Rice University's Baker Institute for Public Policy, COVID-19 has saddled state governments with large revenue shortfalls, highlighted by a 21% decrease in average sales tax revenue in May 2020 compared with a year earlier (Beebe, 2020). Some states have been exploring creative ways to raise money, such as imposing excise taxes on sports betting and daily fantasy sports (DFS). When excise taxes are levied on potentially harmful goods and activities, such as cigarettes, gambling and alcoholic beverages, they are often called

“sin taxes.” However, what constitutes “sinful” products varies over time as a result of evolving cultural, health, and social perspectives. Although “sin taxes” arguably focus on goods and activities that aren't overly controversial, the public debate is continually intense because the tax is imposed, in part, to modify consumers' behaviors.

The distinction on how the DFS industry will be treated as a tax vehicle will ultimately lie in whether fantasy sports are considered a game of chance (i.e. gambling) or a game of skill at the federal level and individually under state law (Baldwin & Zidik, 2016). Even after the two recent rulings by the IRS, there remains considerable debate on whether DFS constitutes gambling. Many DFS industry groups maintain the distinction between DFS and sports betting by emphasizing the skill element of DFS, which is an attempt to increase the chance of legalizing DFS, although the ultimate goal is to legalize both in all states. COVID-19 has provided an unexpected environment for DFS to flourish due to social distancing measures. Such policy measures may continue to fuel the popularity of online sports betting while the pandemic will motivate more states to accelerate its legalization. When debating how to properly tax and legalize DFS activities, the real litmus test will be whether the federal government and individual states can regulate the activities and provide a legitimate environment that protects consumers from disreputable operations and limits the risk of addiction.

REFERENCES

- Baldwin, D. & Zidik, D.J. (2016, February 1). How to Report Clients' Fantasy Football Winnings. *Journal of Accountancy*, 1-2.
- Becker, A. & Sun, X.A. (2016). An Analytical Approach for Fantasy Football and Lineup Management. *Journal of Quantitative Analysis in Sports*, 12(1), 17-30.
- Beebe, J. (2020). Taxing online sports betting, fantasy sports may help states cover pandemic losses. Pixabay: Rice University
- Belien, J., Goosens, D. & Van Reeth, D. (2017). Optimization Modeling for Analyzing Fantasy Sports Games. *INFOR: Information Systems and Operational Research*, 1-120.
- Bonomo, F., Duran, G. & Marenco, J. (2014). Mathematical Programming as a Tool for Virtual Soccer Coaches: A Case Study of a Fantasy Sport Game. *International Transactions in Operational Research*, 21(3), 399-414.
- Boyd, E. (2014). A new method for ranking quarterback fantasy performance with assessment using distances between rankings. Retrieved from: <http://mds.marshall.edu/etd/827>.
- Chan-Olmstead, S. & Kwak, D.H. (2020). Fantasy Sport Usage and Multiplatform Sport Media Consumption. *Sport Marketing Quarterly*, 29, 204-214.
- Chan-Olmstead, S. & Wolter, L.C. (2018). Emotional Engagement in a New Marketing Communication Environment. *The Handbook of Communication Engagement*, 421-437.
- Easton, T. & Newell, S. (2019). Are Daily Fantasy Sports Gambling? *Journal of Sports Analytics*, 3, 35-43.
- Edelman, A. (2011). A Short Treatise on Fantasy Sports and the Law: How America Regulates its New National Pastime. *Harvard Journal of Sports and Entertainment Law*, 3(4), 1-53.
- Edelman, M. (2016). Navigating the Legal Risks of Daily Fantasy Sports: A Detailed Primer in Federal and State Gambling Law. *University of Illinois Law Review*, 2016, 117-150.
- Heitner, D. (2015). The Hypergrowth of Daily Fantasy Sports is Going to Change our Culture and Our Laws. *Forbes* 2015. Retrieved from: <https://www.forbes.com/sites/darrenheitner/2015/09/16/the-hyper-growth-of-daily-fantasy-sports-isgoing-to-change-our-culture-and-our-laws/#66c26d835aca>
- Holden, J.T. (2020). Through the Wire Act. *Washington Law Review*, 95(2), 677-735.
- Holden, J.T., McLeod, C.M. & Edelman, M. (2020). Regulatory Categorization and Arbitrage: How Daily Fantasy Sports Companies Navigated Regulatory Categories Before and After Legalized Gambling. *American Business Law Journal*, 57(1), 113-167.

- Hruby, P. (2013, December 2). The Founding Fathers of Fantasy. *Sports On Earth*. Retrieved from: <http://www.sportsonearth.com/article/64244480/the-founding-fathers-of-fantasy>.
- Hutchins, B. & Rowe, D. (2012). *Sport Beyond Television: The Internet, Digital Media, and the Rise of Networked Sport*. Taylor & Francis.
- Internal Revenue Service. (2020). Memorandum: Office of Chief Counsel (AM2020-009).
- Jessop A. (2018). 21st Century Stock Market: A Regulatory Model for Daily Fantasy Sports. *Journal of Legal Aspects of Sport*, 28, 39-62.
- Lipsyte, R. (1996, March 31). Backtalk; For the Founding Father of Fantasy Baseball, a Reality Check. *New York Times*. New York: NY.
- Leonard, B.M. (2008). Highlighting the Drawbacks of the UIGEA: Proposed Rules Reveal Heavy Burdens. *Drake Law Review*, 57, 515-545.
- Lowe, S.K. & Gilbert, M (2020). Supreme Court Verdict on Legalization of Sports Gambling: Effect on Gaming Revenues. *Journal of Applied Financial Research*, 1, 39– 48.
- Manfred, T. (2015). FIFA made an insane amount of money off of Brazil's \$15 billion World Cup. *Business Insider*. Retrieved from: <https://www.businessinsider.com/fifa-brazil-world-cup-revenue-2015-3>.
- Nesbit, T.M. & King, K.A. (2010). The Impact of Fantasy Sports on Television Viewership. *Journal of Media Economics*, 23, 24-41.
- Newell, S. & Easton, T. (2017). Optimizing Tiered Daily Fantasy Sports: Mathematically Modeling Draft Kings NFL Millionaire Maker Tournament. *Institute of Industrial and Systems Engineers Annual Conference Proceedings*, 289-294.
- Pallotta, F. (2017). More than 111 Million People Watched Super Bowl LI. *CNN Money*. Retrieved from: <https://money.cnn.com/2017/02/06/media/super-bowl-ratings-patriots-falcons/>.
- Peterson, L.A. (2019). The Winning Lineup: Framework for Federal Regulation of Daily Fantasy Sports. *University of Pittsburgh Law Review*, 80(3), 729-751.
- Rose, L.N. & Owens, M.D. (2009). *Internet Gaming Law*. New Rochelle: NY.
- United States Tax Court. (2007). *George and Gloria Tschetscot v. Commissioner*. (T.C. Memo 2007-38).
- United States v. Cohen*. (2001). 260 F. 3d 68 (2d Cir.).

United States v. Lyons. (2014). 740 F. 3d 702 (1st Cir.).

Van Natta, D. (2016). Welcome to the Big Time. ESPN 2016. Retrieved from:
http://www.espn.com/espn/feature/story/_id/17374929/otl-investigates-implosion-daily-fantasysports-leaders-draftkings-fanduel.

Ware, S.B. & Webb, B.A. (2008). *Evaluation of fantasy players*. Yahoo! Inc., U.S. Patent Application 11/606,717.