

Feeling The Limits of McCarran's Power Today – The Remaining Wagering Excise Tax

By Brenda L. Roubidoux Taylor & Gregory R. Gemignani

A threat much closer to home than the communist nations of the Eastern Bloc and People's Republic of China gripped the American public of the 1950s. That threat was organized crime. Congress wasted no time in addressing this threat. Estes Kefauver, a Senator from Tennessee with a desire to ascend to higher office, held hearings on organized crime and its influence on the country. Senator Kefauver was quick to realize the new mass medium of television as a powerful tool for public persuasion. His hearings were televised and often held in prime time.



The Kefauver Committee hearings brought known mafia criminals such as Frank Costello into the living rooms of America to face the grilling of U.S. Senators. It did not take long before the Kefauver Committee hearings began to focus on organized crime's role in a vast criminal gambling enterprise. From there, the Kefauver Committee was able to expose ties between those involved in the vast criminal gambling industry and those involved in Nevada's regulated gaming industry. In many American homes of the 1950s, Nevada gambling was becoming synonymous with organized crime and a threat to the American way of life.

In the 1950s, Congress sought to act by imposing a ten percent (10%) excise tax on all wagers placed in America. The regulated gaming industry in Nevada clearly understood that this was aimed at them and was an attempt to shut down the gaming industry, as such a tax would be crippling. To put this into perspective, based on data published by UNLV, the average win retained by Nevada casinos from 2000-2018 was about 7.6% of all amounts wagered.¹ A 10% tax would have exceeded all revenue retained by a Nevada casino from wagering and, thus, threatened to end the legal and regulated gaming industry.

Fortunately, Nevada had a powerful senator in Pat McCarran, who tried to stall or kill the tax. However, the momentum for the tax was unstoppable in the wake of the televised hearings that cemented public opinion. Senator McCarran, although influential, was just one senator from a small western state with little other clout. Knowing the limits of his ability to kill the tax, Senator McCarran altered course and instead of killing or delaying the tax he worked tirelessly to exempt the bulk of Nevada gaming from the crippling effects of such a tax. Senator McCarran was largely successful in his efforts, as a modified version of the tax bill was enacted with a provision for exempted card games, roulette, slot machines, and dice games when conducted under circumstances in which the wagers are placed, the winners are determined, and the distribution of prizes is made in the presence of all persons participating in the game. McCarran's maneuvering saved the casino industry in Nevada. But without an exemption for sports wagers and non-pari-mutuel horse wagers, 21 of the state's 24 race and sports books closed for business.

The wagering excise tax soon became an information-gathering tool for prosecuting authorities. Those engaged in the wagering business were required to submit a monthly return to the Internal Revenue Service, answering questions about

their wagering activities, which the IRS, in turn, shared with prosecuting authorities. In 1968, the U.S. Supreme Court in *Grosso v. United States*, 390 U.S. 62 (1968), discussed the wagering excise tax stating, “the statutory obligations are directed almost exclusively to individuals inherently suspect of criminal activities. The principal interest of the United States must be assumed to be the collection of revenue, and not the prosecution of gamblers...” The Court reversed a conviction against the Petitioner for failing to pay the excise wagering tax after he argued the excise tax violated his Fifth Amendment rights against self-incrimination since he could reasonably expect information, he provided on the monthly return submitted to the IRS would be shared with state and federal prosecutors. In its opinion, the Court noted “...there is no similar statutory obligation that the Commissioner provide prosecutors with listings of those who have paid the excise tax.”

In response to the Supreme Court decision, an amendment to the wagering tax laws was introduced in the U.S. House of Representatives, which placed statutory restrictions on the disclosure and sharing of wagering activity information. In his introduction of the amendment on the House floor in 1971, Hon. Dante Fascell of Florida proclaimed that as a result of the Supreme Court’s decision, “...gambling enforcement activities of the Internal Revenue Service were brought to a virtual halt. As a consequence, organized crime continues to derive fantastically huge profits from its illegal gambling operations unimpeded by any enforcement.”³ His comments reflected the continuing belief that gambling and organized crime were one and the same.

Over time, the punitive 10% tax has become a 0.25% tax on wagers taken by state licensed (legal) operators and 2% on wagers taken by unlicensed (illegal) operators.⁴ The tax still only excludes state licensed pari-mutuel wagering⁵,

coin or TITO operated devices⁶, state conducted lotteries⁷, and games in which a wager is placed, winners are determined and prizes are distributed in the presence of all persons wagering.⁸ From the 1950s until recently, these exemptions were sufficient to shield the bulk of regulated casino gaming industry activities from major effects of the wagering excise tax. However, today with recent moves by states to regulated sports wagering and online wagering, the tax is poised to hit a broader section of gaming sector revenue.

IMPACT ON SPORTS WAGERING

Senator McCarran’s efforts in the 1950s were successful at avoiding the impact of the tax for much of the gaming industry’s wagering activity. However, sports wagering was not exempted from the tax. When enacted in the 1950s, the 10% tax exceeded what a sports book was likely to hold from sports wagering activity. For example: imagine a book in 1959 taking wagers on the 1959 NFL Championship game between the Giants and the Colts. With a 10% vigorish, bettors would bet \$110 to win \$100, which means losing wagers would lose the \$110 and winning wagers would be paid \$210 (the original \$110 plus \$100 for winning). Assuming a rare occurrence of perfect balance, the book takes \$220,000 in wagers (\$110,000 on each side). After the game, the book pays winning wagers and is left with \$10,000 of hold (essentially the 10% fee from losing wagers). The wagering excise tax, which is applied to all wagers, would be \$22,000, and the book would lose \$12,000 in this scenario. Thus, a 10% wagering excise tax is absolutely crippling.

In 1974, the tax was lowered to 2%, and legal and regulated sports books made a comeback in Nevada. In 1983, Congress once again lowered the tax to its current 0.25% for wagers taken in



compliance with state law by passing the Miscellaneous Revenue Act of 1982. The estimated federal budget effects of this reduction were expected to be a loss of \$8M in 1983, \$14M in 1984, \$16M in 1985, and \$17M in 1986.⁹ While the tax is low and federal budget impact minimal, it is not insignificant to the operators. Take this example from the 2018 Super Bowl: Nevada books took \$158,586,934 of wagers on the Super Bowl. The books were not perfectly balanced and ended up winning \$1,170,432 or about 0.7% of the amounts wagered. From that amount, the books paid wagering excise taxes of \$396,467 to the federal government (0.25% of all wagers placed). After paying this federal tax and state taxes, Nevada books earned (as a state-wide collective) about \$694,960 on the 2018 Super Bowl. In this instance, the federal wagering excise tax was about 34% of the hold retained by the books after winning wagers were placed.



BEYOND NEVADA

In 1964, New Hampshire became the first state to establish a state lottery.¹⁰ New Hampshire's lottery was initially subject to the federal wagering excise tax until Congress passed the Excise Tax Reduction Act of 1965 that included an exemption for state lotteries.¹¹ Debate during the legislative session emphasized the state lottery was "similar to a parimutuel system in horse racing"

and that "since parimutuel wagering licensed under State law was already exempt from the wagering tax", a new exemption should be created for state lotteries. The new exemption was specifically based on the New Hampshire style of lottery, which determined winners by the results of a horse race. The language of the exemption required, in part, for "the ultimate winners in which are determined by the results of a horse race."¹²

More states subsequently established lotteries and other states took measures indicating they would follow suit. As state lotteries grew in number over the years, they did not meet the newly created exemption because they determined the winners by lot and not by horse race. It soon became clear the impact of the federal wagering excise tax would be far-reaching, prompting Congress to take action. In a 1976 report prepared for the Committee on Finance, the Joint Committee on Internal Revenue Taxation wrote:

Since the appearance of the New Hampshire Lottery, several other States have established and are operating lotteries. Several more States have either authorized, or are investigating the feasibility of lottery operations.... Consequently, the lotteries as now conducted, do not satisfy the second requirement for exemption from the tax on wagers, that is, the use of a horse race to determine winners.¹³

Congress passed the Tax Reform Act of 1976, which struck the language requiring winners to be

determined based on a horse race. The history behind exempting state lotteries shows that once the impact of the tax was felt beyond a single state's borders, Congress was compelled to change the law. The original argument used in support of creating an exemption based on its similarity to parimutuel betting did not seem to matter anymore.



Historically, the tax was often ignored by many because it was applicable only to Nevada sports wagering. From 1931 through 2018, Nevada was the only state with wide-open legal and regulated sports betting. This artificial monopoly on legal and regulated broad-based sports wagering was created by a 1992 statute that was later deemed unconstitutional in 2018.

In the wake of the U.S. Supreme Court's opinion holding the Professional and Amateur Sports Protection Act unconstitutional in *Murphy v. NCAA*, states and tribes were no longer prohibited by federal statutes from legalizing and regulating sports betting within their jurisdictions. As of the time of authorship of this article, eleven states have enacted legislation to legalize and regulate sports wagering. In addition, tribes in New Mexico have begun regulating sports wagering on tribal lands. Despite their status as sovereign nations, federally recognized tribes cannot take advantage of the exemption applicable to states because they are not considered "States" for purposes of the federal wagering excise tax.¹⁴

FEELING THE LIMITS OF MCCARRAN'S POWER

Like other gaming issues in the past, what starts in Nevada often spreads across the country. When lottery gaming expanded in 1964, casino gaming expanded beyond Nevada in 1978, and tribal gaming expanded in the late 1980s; all benefitted from the work done by Senator Pat McCarran to limit the impact of federal taxation that could alter the economics of the industry.

However, today, as states and tribes begin the process of licensing and regulating sports wagering, they, like Nevada, will begin to feel the limits of the power wielded by Senator McCarran in the 1950s. As states and tribes move to legalize and regulate sports wagering, the federal wagering excise tax must be taken into account when making financial projections. While the tax appears to be small at 0.25%, the effect of the tax is far greater because it applies to all wagers, even when the book operator is operating on razor thin margins or a loss.

Modern efforts to carve out a new exemption for sports betting have been entirely unsuccessful. U.S. Representative Dina Titus of Nevada introduced a bill in 2014 creating an exemption for sports wagering, which did not gain any traction.¹⁵ She reintroduced the bill again in 2015, with the same result. At the time Representative Titus introduced this legislation, Nevada was the only state offering sports wagering. In a letter to the House Ways and Means Committee reintroducing the bill, Representative Titus wrote the tax was “decades old,” “outdated and in need of reexamination.” She also noted it made up “a miniscule percentage of the federal budget” yet cost Nevada companies \$9.5M to \$11M annually. Recent legislation sponsored by Senator Orrin Hatch signals the excise tax on sports wagering may be here to stay. The Sports Wagering Market Integrity Act of 2018, which was introduced to show bi-partisan Congressional intent on the subject of sports wagering, only proposed changes to how revenue collected from the tax would be spent and did not include any new exemptions.¹⁶

The limits of Senator McCarran's power to curb the excise wagering tax felt primarily by Nevada from 1950 through 2018 are now being felt by an increasing number of other states. Hopefully, as other states and tribes become impacted, Congress will act, as it has in the past, to lessen the burden of this tax on legitimate gaming operations.



Brenda L. Roubidoux Taylor is an attorney at Dickinson Wright, where she practices in Las Vegas, specializing in tax planning and controversy. She has an LL.M. in Taxation and expertise on tax issues specific to the gaming industry. Brenda is an enrolled member of the Iowa Tribe of Kansas and Nebraska, which owns Casino White Cloud in Kansas.

Greg Gemignani is an attorney in the gaming



department of Dickinson Wright. Greg is also an adjunct professor of law at the Boyd School of Law at the University of Nevada Las Vegas more than ten years. In addition, Greg is a lecturer for the International Center for Gaming Regulation on gaming, compliance, technology and sports wagering topics.



- ¹ See Nevada Gaming Revenue: Long-Term Trends (available at <https://gaming.unlv.edu/reports.html>)
- ² See Public Law 183—OCT. 20, 1951 (Section 27A available at <https://www.govinfo.gov/content/pkg/STATUTE-65/pdf/STATUTE-65-Pg452.pdf>)
- ³ See 117 Cong. Rec. (Bound) – Extension of Remarks: February 18, 1971. (available at <https://www.govinfo.gov/app/details/GPO-CRECB-1971-pt18/GPO-CRECB-1971-pt18-1-2>)
- ⁴ See 26 U.S.C. § 4401
- ⁵ See 26 U.S.C. § 4402(1)
- ⁶ See 26 U.S.C. § 4402(2)
- ⁷ See 26 U.S.C. § 4402(3)
- ⁸ See 26 U.S.C. § 4421
- ⁹ See 128 Cong. Rec. (Bound) – House of Representatives: October 1, 1982. (available at <https://www.govinfo.gov/app/details/GPO-CRECB-1982-pt20/GPO-CRECB-1982-pt20-1-2/summary>).
- ¹⁰ Puerto Rico and the U.S. Virgin Islands established lotteries before New Hampshire.
- ¹¹ See Tax Revision Issues – 1976 (H.R. 10612), Administrative Matters, Committee on Finance, Joint Committee on Internal Revenue Taxation, April 14, 1976, JCS-13-76. (available at <https://www.jct.gov/publications.html?func=startdown&id=3848>)
- ¹² See Pub. L. 89-45, Sec. 813(a)(3)(B) dated June 22, 1965. (available at <https://www.govinfo.gov/content/pkg/STATUTE-79/pdf/STATUTE-79-Pg170.pdf>)
- ¹³ See Tax Revision Issues – 1976 (H.R. 10612), Administrative Matters, Committee on Finance, Joint Committee on Internal Revenue Taxation, April 14, 1976, JCS-13-76. (available at <https://www.jct.gov/publications.html?func=startdown&id=3848>)
- ¹⁴ See JCX-61-08, “Overview of Federal Indian Tax Provisions Relating to Native American Tribes and Their Members” by Joint Committee on Taxation dated July 18, 2008 (available at <https://www.jct.gov/publications.html?func=fileinfo&id=1278>)
- ¹⁵ See H.R. 5383 – 113th Congress (2013-2014) (available at <https://www.congress.gov/bill/113th-congress/house-bill/5383?s=3&r=1>)
- ¹⁶ See S. 3793 – 115th Congress (2017-2018) (available at <https://www.congress.gov/bill/115th-congress/senate-bill/3793/text>)