Loyola of Los Angeles
Entertainment Law Review

Volume 44 | Number 1 Article 1

Fall 12-13-2023

Getting a Handle on the Taxation of Sports Betting

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GETTING A HANDLE ON THE TAXATION OF SPORTS BETTING

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Sports betting is not merely a 21st century novelty; however, recent legislative and societal changes have allowed sports betting to bloom into a widespread phenomenon in America. The rapid emergence of sports betting in American life has caused states to react with legislation ranging from full-stop bans to partnerships with sportsbooks to capitalize on this lucrative and newly legal activity. While plenty of discussion can be found regarding the social and political considerations of legalizing gambling and related activities, no comprehensive legal scholarship has focused specifically on the taxation of sports betting. Sports betting exists in a relatively unique position as an activity that is now federally legal but not uniformly legal nationwide due to differences in state law. It comes as no surprise that as a result, a variety of different approaches to taxing sports betting has emerged, and it is worth considering the current legal and mechanical challenges in raising revenue from America's favorite new vice.

This Article begins by providing a brief background of how sports betting became legalized, including the relevant legislation and litigation related to sports betting. The Article then turns to the taxation of sports betting in Section III, examining both the federal and state-level tax laws and taxation schemes concerning both individual bettors and sports betting operators. Because the legal sports betting industry is in its infancy, many of the foreseeable legal challenges to regulating and taxing this activity have not been fleshed out by the federal and state courts, or legislatures. Understanding the mechanics of a sports betting transaction from the consumer and sportsbook's perspective are key in understanding the subsequent tax ramifications. This Article then attempts to identify three primary areas of tax law in Section IV where legal challenges are either currently ongoing or could arise in the near future. First, how states determine nexus and sourcing in taxing sports betting operators both currently and under alternative structures such as multistate agreements. Second, the Internet Tax Freedom Act, particularly

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concerning states with a two-tiered tax structure on sports betting. This section covers the litigation out of Maryland regarding the state's digital advertising tax and discusses how the Internet Tax Freedom Act may be problematic for states that levy a higher tax rate on online sports betting than in-person betting. Finally, the Article covers the role tribal compacts play in the sports betting landscape, focusing on the recent litigation out of Florida and how Florida's attempt to legalize sports betting via a tribal compact implicates concerns about determining tax nexus and the relationship of federal and state laws in the context of sports betting.

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I. INTRODUCTION

On May 14, 2018, the U.S. Supreme Court issued its ruling in *Murphy v. NCAA*, holding that the Professional and Amateur Sports Protection Act ("PASPA") violated the Tenth Amendment of the U.S. Constitution.[1] PASPA was a direct attack on states' choices for the type of gambling allowed by their law, which was largely what rendered the statute constitutionally problematic.[2] Following the *Murphy* decision, states rushed to legalize, regulate, and tax sports betting, America's "most lucrative vice."[3] Although *Murphy* opened the floodgates for sports betting at an intrastate level, interstate betting remains illegal pursuant to the Federal Wire Act.[4] As states continue to legalize, regulate, and tax sports betting both in-person and online, individuals across the nation have rushed to place their bets with a number of national and local sports betting Operators.[5] In 2022 alone, the nationwide sports betting revenue was $7.5 billion, up 61.1% from the prior year.[6] In spite of the fact that a majority of states have legalized sports betting in some form, three of the nation's four largest states have yet to enter the legal sports betting market: California, Texas, and Florida.[7]

The Internet Tax Freedom Act ("ITFA") was enacted to prevent the imposition of some types of state and local taxes on electronic commerce and internet access.[8] Congress decided that permitting tens of thousands of

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1. Murphy v. NCAA, 138 S. Ct. 1461, 1484-85 (2018).

2. John Holden & Marc Edelman, *A Short Treatise on Sports Gambling and the Law: How America Regulates Its Most Lucrative Vice*, 2020 WIS. L. REV. 907, 943 (2020).

3. *Id.* at 907.

4. 18 U.S.C. § 1084(a).

5. Hereinafter, businesses that offer sports betting which most commonly take the form of a standalone sportsbook or a casino-affiliated sportsbook are referred to as "Operators."

6. *Commercial Gaming Revenue Tracker*, AM. GAMING ASS'N (2022), https://www.americangaming.org/wp-content/uploads/2023/02/CGRT_CY_2022_Report.pdf [https://perma.cc/UT4E-GLL5].

7. Larger states represent a larger opportunity for tax revenue, but California, Texas, and Florida have faced significant hurdles in their efforts to legalize sports betting. *See infra* Section IV.C (examining Florida's legal limbo with respect to attempting to legalize sports betting via tribal compact).

8. *See* Internet Tax Freedom Act, Pub. L. 105-277, § 1101(a)(1-2), 112 Stat. 2681-719 (1998); Pub. L. 114-125, Tit. IX, § 922, 130 Stat. 281 (2016) (codified at 47 U.S.C. § 151 note);

taxing jurisdictions to impose multiple and discriminatory taxes on electronic commerce would cripple the growth of the internet, or substantially affect interstate commerce.[9] ITFA defines a discriminatory tax as any state tax imposed on electronic commerce that "is not generally imposed and legally collectible at the same rate by such state … involving similar property, goods, services, or information accomplished through other means."[10] In spite of ITFA's anti-discrimination clause, some states have chosen to impose a two-tiered tax rate system on sports betting, where online betting is taxed at a higher rate than in-person, or retail betting.[11] It seems as though these states' two-tiered tax system is vulnerable to attack under ITFA.[12]

Florida and California have tried to pass legislation to allow sports betting in their states, which would undoubtedly raise significant revenues given the combined population of roughly 60 million, but have failed to do so.[13] Litigation arising out of Florida regarding the state's efforts to legalize sports betting through a tribal compact failed to answer many questions, such as how federal laws like the Indian Gaming Regulatory Act ("IGRA") and the Wire Act interact with one another, or how nexus and sourcing is determined for wagering activity off tribal land.[14]

II. SPORTS BETTING IN AMERICA

A. Background

Gambling in America has long been associated with revenue-raising efforts by the government. Even before the signing of the Declaration of

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see also Jeffrey Friedman & Alla Raykin, *Congress's Preemption of State Tax Laws Is Not Commandeering,* 101 TAX NOTES STATE 1085, 1086 (Sept. 6, 2021).

9. Friedman & Raykin, *supra* note 8, at 1090.

10. 47 U.S.C. § 151 note (Internet Tax Freedom Act).

11. *See infra* Table 2.

12. Jeffery Friedman & Sebastian Iagrossi, *A Review of State Taxation of Sports Betting*, 107 TAX NOTES STATE 44 (2023) (citing Internet Tax Freedom Act § 1105(2)(A)(ii)).

13. *QuickFacts: California; Florida; New York; Texas*, U.S. CENSUS BUREAU, https://www.census.gov/quickfacts/fact/table/CA,FL,NY,TX/PSTe045221 [https://perma.cc/WM2E-HTN4].

14. *See infra* Section IV.C.

Independence, American lotteries were used to finance the construction of roads, hospitals, jails, and universities.[15] As professional sports began to take shape as a dominant 20th-century industry, individuals nationwide began wagering on sports. Although sports betting was not legal, the lack of enforcement by state and local authorities allowed it to grow, eventually becoming a nationwide business that concerned Congress. In 1992, PASPA was enacted, and made it unlawful for any state to "sponsor, operate, advertise, promise, license, or authorize by law or compact," sports betting.[16] However, the law carved out an exemption for any state that allowed or operated a sports betting scheme at any time between 1976 and 1990, which effectively created a loophole to exempt Nevada sportsbooks from the national ban on sports betting.[17] PASPA didn't stop New Jersey from legalizing sports betting in 2012, when the NCAA and four major professional leagues sued New Jersey in the litigation that would ultimately lead to the landmark Supreme Court decision, *Murphy*.[18] In spite of the pending litigation, it is noteworthy that Adam Silver, the commissioner of the NBA at the time when the *Murphy* litigation began, wrote an op-ed in The New York Times taking the stance that sports betting should be allowed on a federal level as long as the states comply with strict rules.[19] Silver would go on to become a strong advocate for the legalization of sports betting, so perhaps unsurprisingly, just two months after the Supreme Court decided *Murphy*, the NBA announced a multi-year deal with MGM Resorts that made the sports betting Operator the official gaming partner of the NBA and WNBA.[20]

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15. Ronald Rychlak, *Lotteries, Revenues and Social Costs: A Historical Examination of State-Sponsored Gambling*, 34 B.C. L. REV. 11, 25-26 (1992) (explaining that between 1746 and the Civil War, lotteries helped fund the establishment and construction of 47 colleges, 300 lower schools, and 200 church groups).

16. 28 U.S.C. § 3702.

17. Eric Meer, *The Professional and Amateur Sports Protection Act (PASPA): A Bad Bet for the States*, 2 UNLV GAMING L.J. 281, 287 (2011).

18. Murphy v. NCAA, 138 S. Ct. 1461, 1470 (2018).

19. Adam Silver, *Legalize and Regulate Sports Betting*, N.Y. TIMES (Nov. 13, 2014), https://www.nytimes.com/2014/11/14/opinion/nba-commissioner-adam-silver-legalize-sports-betting.html [perma.cc/7EGW-M98J].

20. Michael McCann, *What the NBA and Its Players Stand to Gain From Partnership with Vegas-Based MGM*, SPORTS ILLUSTRATED (July 31, 2018), https://www.si.com/nba/2018/08/01/nba-mgm-resorts-partnership-vegas-sports-betting [https://perma.cc/XS4J-HSXM].

Gambling regulations are traditionally viewed and treated as a states' rights issue, but the federal government still uses its lawmaking authority to steer policy decisions. In the post-*Murphy* landscape, the primary federal law prohibiting interstate sports betting is the Wire Act, which was passed in 1961 and became the first major statute to target sports betting federally.[21] Pioneered by the U.S. Attorney General, Robert F. Kennedy, the Wire Act stood as a primary tool to be used in the fight against organized crime.[22] Kennedy stated that:

> [T]he Federal Government is not undertaking the almost impossible task of dealing with all the many forms of casual or social wagering which so often may be effected over communications. It is not intended that the [Wire Act] should prevent a social wager between friends by telephone. This legislation can be a most effective weapon in dealing with one of the major factors of organized crime in this country without invading the privacy of the home or outraging the sensibilities of our people in matters of personal inclination and morals.[23]

It was not until the advent of the internet, decades after the Wire Act was signed into law, that anyone really questioned the Wire Act's scope.[24] The first version of the bill contained a tailored focus on horseracing, later modified to broadly include sporting events and contests.[25] However, over time, the Wire Act has been subject to cyclical interpretations by the Department of Justice ("DOJ") and the courts. In 2002, the U.S. Court of Appeals for the Fifth Circuit held that the Wire Act's prohibition on the transmission of wagers applies only to sports betting and not other types of online

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21. John T. Holden, *Through the Wire Act*, 95 WASH. L. REV. 677, 679 (2020).

22. *Id.*

23. *Hearings on S. 1653, S. 1654, S. 1655, S. 1656, S. 1657, S. 1658, and S. 1665 Before the S. Comm. on the Judiciary*, 87th Cong. 6 (1961).

24. *Id.*

25. *See Transmission of Gambling Information: Hearing on S.3358 Before the Subcomm. of the Comm. on Interstate and Foreign Com.*, 81st Cong. 1 (1950); *Legislation Relating to Organized Crime: Hearings on H.R. 468, H.R. 1246, H.R. 3021, H.R. 3022, H.R. 3023, H.R. 3246, H.R. 5230, H.R. 6571, H.R. 6572, H.R. 6909, and H.R. 7039 Before the Subcomm. No. 5 of the H. Comm. on the Judiciary*, 87th Cong. 20 (1961).

gambling.[26] Nearly a decade later, in 2011, the DOJ issued a memorandum that concluded the Wire Act only applied to sports betting.[27] Then, in November 2018, the DOJ clarified its stance in its latest memorandum on the subject (the "2018 Opinion"), stating the Wire Act applies to all gambling and not just sports betting.[28] The 2018 Opinion has been challenged, for example in 2021 when in *N.H. Lottery Commission v. Rosen*, the First Circuit Court of Appeals held that the prohibitions in the Wire Act "apply only to the interstate transmission of wire communications related to 'any sporting event or contest,'" but failed to exercise its authority to formally vacate the 2018 Opinion.[29] After the First Circuit's decision in *NHLC*, the U.S. District Court for Rhode Island followed suit in a case where an Operator brought action against the Attorney General and the DOJ, seeking a declaratory judgment that the DOJ could not prosecute them for non-sports betting activities under the Wire Act.[30] The dilemma before the Operator was to either abandon their business activities or risk prosecution, much like in *NHLC*.[31] The Court held that the Operator "should not have to operate under a dangling sword of indictment while DOJ purports to deliberate without end the purely legal question it had apparently already answered and concerning which it offers no reason to expect an answer favorable to the plaintiffs."[32] The court granted summary judgment in favor of the Operator, noting that it faced a credible threat of prosecution but also stated the opinion's conclusion that "as to the parties now before it, the Wire Act applies only to 'bets or wagers on any sporting event or contest.'"[33] As a result, for Operators offering online sports betting, they must rely on geolocation technology to ensure

26. *In re* MasterCard Int'l. Inc., 313 F.3d 257, 262 (5th Cir. 2002).

27. Whether the Wire Act Applies to Non-Sports Gambling, 35 OP. O.L.C. 134, 148 (2011).

28. Reconsidering Whether the Wire Act Applies to Non-Sports Gambling, 42 OP. O.L.C. 1, 23 (2018) [hereinafter, the "2018 Opinion"].

29. N.H. Lottery Comm'n v. Rosen, 986 F.3d 38, 62 (1st Cir. 2021) [hereinafter *"*NHLC*"*].

30. Int'l Game Tech. PLC v. Garland, 628 F. Supp. 3d 393, 396 (D.R.I. 2022) (the Court drew on the undisputed facts before it to reach its opinion, relying in part on the procedural history discussed in NHLC).

31. *Id.* at 405 (citing MedImmune, Inc. v. Genentech, Inc., 549 U.S. 118, 129 (2007)).

32. *Id.* (quoting NHLC at 53).

33. *Id.*

legal compliance.[34] Without geolocation, there would be no way to ensure online betting is a purely intrastate activity for both state taxation purposes and compliance under the Wire Act.

Critics of the Wire Act argue that the law was never intended to exist in a world with widespread legalized sports betting and it was passed in an era when gambling was almost wholly illegal.[35] While the *Murphy* majority appeared to be targeting intrastate sports wagers as activities within states' police powers to allow or prohibit, history has proven that sports gambling businesses, especially illegal operations, have not respected state boundaries.[36] *Murphy* took aim at PASPA; however, there are far more laws that concern gambling at a federal level, including the Johnson Act,[37] the Illegal Gambling and Business Act,[38] the Racketeer and Corrupt Organizations (RICO) Act,[39] and the Unlawful Internet Gambling Enforcement Act (UIGEA).[40] The Supreme Court summarized the policy considerations of the sports gambling argument in *Murphy*, stating:

> The legalization of sports gambling is a controversial subject. Supporters argue that legalization will produce revenue for the States and critically weaken illegal sports betting operations, which are often run by organized crime. Opponents contend that legalizing sports gambling will hook the young on gambling,

34. Commonly, bettors place bets using a mobile application, where the app utilizes geolocation to pinpoint a user's location, typically through accessing the GPS data of the user's device when operating the app. J.R. Duren, *Geolocation An Essential Tool Of Online Sports Betting*, PLAY MARYLAND (June 1, 2022), https://www.playmaryland.com/geolocation-an-essential-tool-of-online-sports-betting/ [https://perma.cc/HAX7-6ZU3].

35. *See* Holden, *supra* note 21, at 722.

36. Michael K. Fagan, *Murphy v. NCAA: Wrongly Decided by the Supreme Court (and Here's Why)*, 5 UNIV. OF ILL. L. REV. 1649, 1652 (2021).

37. *See generally* 15 U.S.C. §§ 1171-1178.

38. *See generally* 18 U.S.C. § 1955.

39. *See generally* 18 U.S.C. §§ 1961-1968.

40. *See generally* 31 U.S.C. §§ 5361-5367.

> encourage people of modest means to squander their savings and earnings, and corrupt professional and college sports.[41]

Notably, the Supreme Court has not yet ruled on the meaning of the Wire Act as it pertains to online gambling. However, as states continue to legalize sports betting, there may come a time in the not-too-distant future when the Supreme Court hears a case arising under the Wire Act and provides a degree of certainty and finality to the issue. As discussed below, the Supreme Court did refer to the Wire Act in its *Murphy* opinion, which may be a sign that the Court is at least peripherally aware of the problems presented in this Article.[42]

B. Sports Betting, Defined

In analyzing the legality and subsequent taxation of sports betting, it is essential to be clear on how the activity is defined. Gambling, generally, has three elements: prize, consideration, and chance.[43] Accordingly, Operators control the element of chance because (1) the activity that determines the element of chance is independent of the bettor, and (2) the degree of chance is determined by oddsmakers, also called bookmakers.[44] There are three categories of gambling: (1) lotteries, (2) wagering, and (3) gaming.[45] Sports betting falls within the second category because bettors wager money to bet against odds set by a bookmaker, in which the payout on a given proposition is fixed at the time the bet is made.[46] Understanding where sports betting

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41. Murphy v. NCAA, 138 S. Ct. 1461, 1484 (2018).

42. *See infra* Section IV.A (discussing the potential creation of a multi-state sports betting compact).

43. William Bunting, *A Better Legal Definition of Gambling: With Applications to Synthetic Financial Instruments and Cryptocurrency*, 86 ALB. L. REV. 257, 259 (2023).

44. *See generally* James Chen, *Bookie: Definition, Meaning, Duties, How They Make Money, and Fee*, INVESTOPEDIA (Aug. 21, 2023), https://www.investopedia.com/terms/b/bookie.asp [https://perma.cc/7EY8-DXTD].

45. *See* Bunting, *supra* note 43, at 264.

46. *Id.* at 267 (noting that lotteries involve little to no skill, while gaming activities such as blackjack or poker involve some amount of skill); *see also* 31 U.S.C. § 5362(1)(A) ("The term bet or wager [. . .] means the staking or risking by any person of something of value upon the outcome of a contest of others, *a sporting event*, or a game subject to chance, upon an agreement or

falls on the broader gambling spectrum is vital because both state and federal laws draw distinctions between various gambling activities for regulatory and taxation purposes; lotteries, sports betting, and poker are all gambling, but fall into three separate subcategories that inevitably get regulated in different ways.

The most popular method of sports betting in the United States is "fixed odds wagering," whereby the bettor and Operator agree to the odds and payout.[47] There are several types of fixed odds wagers, including moneyline bets, point spread bets, parlays, and proposition bets. Moneyline betting is the most common and straightforward type of betting. To explain the different types of wagers, consider the following example:

> BigSportsbook, an Operator, is setting the odds for Sunday football. The Browns play the Steelers, and the Browns are favored to win. BigSportsbook sets the following bets for the game:

TABLE 1

	SPREAD (-110)	MONEYLINE
BROWNS	-2.5	-150
STEELERS	+2.5	+120

> The minus (-) indicates who the favorite is, so here, the Browns are the favorites to win. A moneyline odds of -150 means there is an implied probability of 60% that the Browns will win the game; therefore a bettor must wager $150 to win $100. The Steelers moneyline odds are set at +120, meaning the implied probability they will win is about 45% and a bettor must wager $100 to win $120.
>
> The point spread for this game is set at 2.5 points, meaning the Browns need to win by at least 2.5 points for that bet to win. Alternatively, if the Steelers win the game, or lose by less than 2.5

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understanding that the person or another person will receive something of value in the event of a certain outcome.") (emphasis added).

47. Anthony Cabot & Keith Miller, *Sports Wagering in America: Policies, Economics and Regulations*, UNLV GAMING PRESS (2018), https://digitalscholarship.unlv.edu/gaming_infographics/20/ [https://perma.cc/YY8H-QLKZ].

> points, a point spread bet on the Steelers will win. The odds for that bet are set at -110, so a bettor must wager $110 to win $100, regardless of which team they bet on.
>
> A proposition bet on the game would have nothing to do with the outcome. For example, BigSportsbook may allow bettors to wager on whom the first player to score a touchdown is or the color of the halftime performer's shoes.

Sportsbooks also charge customers "juice" or "vig" on virtually every bet, which is essentially a fee to ensure and maximize Operator profitability.[48] Bettors commonly look at the juice to calculate the viability of the bet or the disadvantage a bet may imply under the given odds. For example, a team with a moneyline odds of +900 is seen as unlikely to win, with +900 representing an implied probability of a 10% chance to win. The Operators have a built-in advantage because of the vig, while bettors have to not only win their wagers but do so often enough to beat the vig.[49] Generally, the subjective probabilities sum to more than one, with the difference representing the commission or hold (in percentage terms) to the sports book.[50] In more traditional forms of commerce, to turn a profit, sellers will set the price of a product such that the revenue will outweigh their expenses, which broadly include operating expenses, manufacturing expenses, and taxes. Consumers generally understand this concept and accept the price of a product knowing the price tag represents a cost far beyond the mere product itself. However, when Operators set their "price" by determining the odds for a given sporting event, it is unclear whether Operators can (or do) price their taxes into the juice they charge to bettors. Suppose Operators do pass down the cost of paying Uncle Sam to their customers. In that case, individual bettors are effectively paying up to four different taxes (to varying degrees) when they wager: the Operator's federal excise tax, the Operator's state tax, and their own income tax at both the state and federal levels if their wager hits. Accordingly, casual bettors are more likely to be unaware of this significant cost-shifting mechanism that is built into an Operator's business

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48. Christopher Feery, *What Is Vig in Sports Betting?*, LEGAL SPORTS REPORT (Mar. 21, 2023), https://www.legalsportsreport.com/sports-betting/vigorish/ [https://perma.cc/J8V8-SFJ8].

49. *Id.*

50. Craig Depken II & John Gandar, *Integrity Fees in Sports Betting Markets*, 47 EASTERN ECON. J. 76, 80 (2021).

model. While the house always wins, a more careful examination of an Operator's oddsmaking practices might expose just how much the house really wins.[51]

It should also be noted that another popular form of sports betting exists that does not involve traditional wagering: Daily Fantasy Sports ("DFS"). In DFS, the participant-bettors may use some degree of skill to select a lineup of individual athletes, but then earn points based on the real-world performance of the selected athletes over which the participants have no control. DFS contests involve a group of participants that pay an entry fee for a chance to win, where all the entry fees are pooled and paid out to the winner(s). As discussed below, the tax treatment and potential pitfalls with this type of sports betting from a regulatory and taxation perspective differs only slightly from the traditional wagering model of sports betting.

III. TAXATION OF SPORTS BETTING

In taking a deeper look into the taxation of sports betting, a few important distinctions must be made. First, taxes can generally be levied against an individual bettor and a sports betting operator. Section A will detail the tax treatment of individuals. Second, taxes are levied at both the state and federal levels. Section B will detail the federal excise tax levied on Operators and then provide a more detailed analysis of the state-level tax structure(s) that exist.

A. Taxation of Individual Bettors

At its simplest, there are two types of taxation on sports betting: (1) the individual tax, and (2) the Operator tax. To illustrate, consider the following scenario:

> Anthony and Beth want to bet on a football game, so both parties place a bet with BigSportsbook, an Operator. Anthony bets $11 on the Browns, and Beth bets $11 on the Steelers. The Browns vs. Steelers game offers betting odds for the game, -110 for both teams, meaning an $11 wager to win $10.

51. "The house always wins" is a common phrase referring to the fact that all gambling is designed so that the house (casinos, racetracks, sportsbooks, etc.) will always net a profit, regardless of bettors' success.

> When Anthony and Beth place their bets, the sportsbook has $22. The Browns win, so Anthony gets paid out $21 (the original $11 bet plus $10 in winnings), and Beth loses her $11 wager. After BigSportsbook pays out Anthony, it keeps $1.
>
> Anthony and Beth will need to report their bets on their individual taxes. Anthony must report $10 in winnings, while Beth *may* deduct her $11 in losses, subject to limitations. This is the "individual tax" portion of the transaction.
>
> Pursuant to state law where BigSportsbook accepts wagers, BigSportsbook only pays taxes on its gross gaming revenue, defined as betting handle[52] minus total winnings paid, and the state tax rate is 15%. Accordingly, BigSportsbook will pay $0.15 in state taxes on its $1 of gross gaming revenue. At a federal rate of 0.25% being levied on the betting handle ($22), the federal excise tax is at $.055. For these two bets, BigSportsbook will have a total tax burden of $0.205, or a roughly 20% effective tax rate on its profit. This is the "Operator tax" portion of the transaction.

For individuals, sports betting winnings are considered income, meaning winnings may be subject to federal and state income taxes. Gambling winnings are subject to federal income tax reported on Form 1040, and one may deduct gambling losses only if one itemizes their deductions on Schedule A of Form 1040 and maintains adequate recordkeeping.[53] The IRS issued guidance on reporting sports betting winnings and losses:

> Generally, if you receive $600 or more in gambling winnings, the payer is required to issue you a Form W-2G. If you have won more than $5,000, the payer may be required to withhold 28% of the proceeds for Federal income tax. However, if you did not provide your Social Security number to the payer, the amount withheld will be 31%. The full amount of your gambling winnings for the year must be reported on line 21, Form 1040. If you

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52. *See infra* note 59.

53. *Gambling Income and Losses*, I.R.S., https://www.irs.gov/taxtopics/tc419 [https://perma.cc/WQ8Y-F8RD] (clarifying that while this IRS guidance is meant for casual gamblers who are not in the trade or business of gambling, even individuals that bet on sports as a profession would need to report winnings as income).

> itemize deductions, you can deduct your gambling losses for the year on line 27, Schedule A (Form 1040). Your gambling loss deduction cannot be more than the amount of gambling winnings. It is important to keep an accurate diary or similar record of your gambling winnings and losses. To deduct your losses, you must be able to provide receipts, tickets, statements or other records that show the amount of both your winnings and losses.[54]

While most individuals are considered "casual" bettors, professional gambling can be considered a trade or business and consequently receive alternative tax treatment, whereby unlike casual gamblers, professionals only report on their tax returns their net income from gambling and may deduct losses and other expenses from their winnings.[55] The Supreme Court's decision in *Commissioner v. Groetzinger* made it clear that if one's gambling activity is pursued "full time, in good faith, and with regularity to the production of income for a livelihood, and is not a mere hobby, it is a trade or business" for income tax purposes.[56] A temporary modification under the Tax Cuts and Jobs Act ("TCJA") to the deduction for gambling losses under Internal Revenue Code ("IRC") § 165(d) for tax years 2018-2025 limits the losses professional gamblers are allowed to claim as a deduction to the amount of gains from wagering transactions, even if further expenses were incurred as part of the trade or business of gambling.[57] The IRS Chief Counsel's Office explained that although the statutory language of the TCJA amendment does not indicate if the amendment applies to all taxpayers or only to individuals, the legislative history clarifies that the TCJA amendment was intended only to cover expenses incurred in the conduct of an individual's gambling activity.[58]

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54. *Gambling Income and Expenses*, I.R.S., https://www.irs.gov/pub/irs-news/at-01-17.pdf [https://perma.cc/9NBY-WG4T].

55. *See* Comm'r v. Groetzinger, 480 U.S. 23, 35 (1987) ("[T]o be engaged in a trade or business, the taxpayer must be involved in an activity with continuity and regularity and [. . .] the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify.").

56. *Id.* at 35; *see also* I.R.C. § 62.

57. I.R.S. Chief Couns. Advice 202111012 (Feb. 16, 2021) ("The TCJA amendment to [IRC] section 165(d) does not apply to the ordinary and necessary expenses of a business in the trade or business of gambling.").

58. *Id.*

States have chosen to legalize and tax sports betting with the prospect of raising revenue, but because the adage "the house always wins" is not only accurate, but also relevant for a taxation analysis, this Article primarily focuses on the taxation of Operators, rather than the taxation of individual bettors.

B. Taxation of Operators

The first federal tax on gambling was passed in 1954 and was an excise tax of 10% of the Operator's betting handle.[59] The term "handle" simply refers to the amount of money wagered by bettors, or the Operator's total revenue. Then in 1982, Congress enacted a federal excise tax specific to sports wagers.[60] The federal tax on wagers, currently levied at 0.25% of the handle, can be a substantial obstacle for Operators because such businesses are still responsible for paying state (and potentially local) taxes.[61] Commentators have noted similarities between the marijuana industry and sports betting, primarily due to the relationship between state and federal law and incongruities between states' laws.[62] Importantly, if a state legalizes sports betting, it is not at odds with federal law, unlike with marijuana legalization.[63] Accordingly, the federal government is unable to collect tax revenue directly from marijuana through an excise tax, whereas sports betting is taxed at both state and federal levels. This balance of federalism is important to keep in mind when considering the relationship between taxing authorities and Operators; however, since there is uniform treatment of sports betting at

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59. I.R.C. § 4401; *see also* John E. Coons, *The Federal Gambling Tax and the Constitution*, 43 J. CRIM. L. CRIMINOLOGY & POLICE SCI. 637, 637 (1953).

60. *See* Miscellaneous Revenue Act of 1982, Pub. L. No. 97-362, § 109(a), 96 Stat. 1731, 1731 (1982) (codified at I.R.C. § 4401); *see also* I.R.C. § 4421(1)(A) (the term "wager" includes any bet with respect to any sports event or contest placed with a person engaged in the business of accepting such bets).

61. *See generally* I.R.C. § 4401(a); I.R.C. § 4401(b) (the tax on "unauthorized" wagers, such as illegal sportsbooks, is 2%); Ulrik Boesen, *Large Spread in Tax Treatment of Sports Betting Operators*, TAX FOUNDATION (Feb. 9, 2022), https://taxfoundation.org/sports-betting-tax-treatment/ [https://perma.cc/3YW8-NNT4].

62. *See, e.g.*, Andrew Appleby, *Designing the Tax Supermajority Requirement*, 71 SYRACUSE L. REV. 959, 989 (2020); John Holden & Marc Edelman, *Regulating Vice: What the U.S. Marijuana Industry Can Learn from State Governance of Sports Gambling*, 2021 U. ILL. L. REV. 1051 (2021).

63. *See* Appleby, *supra* note 62, at 994.

the federal level, meaning sports betting is legal and taxable, an analysis at the state level provides much more insight as to the taxation of sports betting.

With respect to DFS, some have argued, albeit unsuccessfully, that playing fantasy sports involves much more skill than standard wagering and should be classified as a "skill-game," which would exempt DFS from the federal excise tax on wagers. The IRS disagrees with this position. In a 2020 memo, the IRS found that a DFS entry fee is a wager, and that a wager does not necessarily require the element of chance.[64] In a separate memo on the issue of deductibility of wagering losses under § 165(d) of the IRC, the IRS made it clear that DFS are not skill games and observed that whatever skill may be involved with selecting players, "the taxpayer's skill has no impact on the players' live performance," and therefore chance dominates the outcome of the contest.[65] As a result, DFS entry fees are treated the same as traditional sports wagers and will be subject to the federal excise tax levied against Operators, but DFS may be treated differently than traditional sports betting at a state level.

Unlike the federal tax, which is taxed against the Operators' handle, state taxes, while notoriously varied, are most commonly imposed on an Operator's gross receipts from sports gambling, called the Operator's gross gaming revenue ("GGR").[66] For example, Rhode Island has taken a particularly interesting approach to taxing sports betting. Rhode Island entered into an agreement with International Game Technology PLC ("IGT"), a sports betting company, and as a result, IGT was granted the sole license to operate sports betting online in exchange for a significant tax rate (51%) on the company's GGR.[67] Contrast the Rhode Island approach with Nevada, perhaps the state most commonly associated with gambling in general, where Nevada offers a competitive tax rate to encourage competition amongst

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64. I.R.S. Gen. Couns. Mem. 2020-009 (July 23, 2020) ("A DFS entry fee fits into the definition of wager under both I.R.C. § 4421(1)(A) and (B). A DFS entry fee is a wager of money by the participant with respect to a sports event or contest placed with a person engaged in the business of accepting such wagers (the DFS operator) as described in I.R.C. § 4421(1)(A).").

65. *See* 26 U.S.C. § 165(d); *see also* I.R.S. Gen. Couns. Mem. 202042015 (Sept. 14, 2020).

66. These sports gambling taxes can be best described as modified gross receipts taxes because they frequently allow a deduction for winnings paid to players and some states also allow for additional tax deductions for things like promotional bets.

67. *See* Hillary Russ, *Rhode Island Legalizes Sports Betting, Gets 51 Percent of Revenues*, REUTERS (June 22, 2018, 2:30 PM), https://www.reuters.com/article/us-usa-betting-rhode-island/rhode-island-legalizes-sports-betting-gets-51-percent-of-revenues-idUSKBN1JI2TQ [https://perma.cc/9LKN-3XRC].

Operators and bring consumers away from the black market.[68] An alternative revenue-raising method for states involves legalization via tribal compacts, where states allow sports betting only at Native American tribal lands in exchange for a share of revenue.[69] However, most states have chosen to simply levy taxes on Operators' GGR.[70] In Tennessee, where sports betting has been legal since 2019, lawmakers passed legislation, effective July 1, 2023, representing a departure from taxing Operators' adjusted gross income to instead adopt a monthly 1.85% "privilege tax" on all bets handled.[71] This makes Tennessee the only state to tax Operators on their betting handle, similar to the federal excise tax, but the Tennessee legislature included a provision to allow for Operators to deduct the 0.25% federal excise tax on wagers from the state's handle tax.[72]

While states have almost uniformly adopted a tax on GGR, states vary in their treatment of GGR because of carveouts in the law for things like promotions and deductions. Operators often use promotional bets to entice individuals to begin betting on sports, but when a bettor takes advantage of such an offer, like a free bet, that figure is generally included in the Operator's GGR. To illustrate, consider the following example:

> Steve lives in a state that recently legalized sports betting, and an in-state Operator offers new bettors $100 in free bets. Steve wagers his whole free promotional bet on the Browns but loses. While no money has changed hands, and the Operator's "true" revenue is $0, the GGR would indicate that the Operator has had $50 of gross revenue and would be required to pay tax on that bet, despite never actually realizing any actual profit on the transaction.

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68. John Holden & Kathryn Kisska-Shulze, *Taxing Sports*, 71 AM. U. L. REV. 845, 896 (2020).

69. *See infra* Section IV.C.

70. Holden & Kisska-Shulze, *supra* note 68.

71. Matthew Pertz, *Tennessee to Tax Sportsbooks' Total Betting Volume, Not AGI*, 108 TAX NOTES STATE 967, 967 (2023) (citing S.B. 475, 113th Gen. Assemb., 1st Reg. Sess. (Tenn. 2023)).

72. *Id.*

Perhaps unsurprisingly, Operators argue against the inclusion of these free promotional bets in their GGR because it increases their tax base without accurately representing their true profits, taxing revenue that does not exist. To address this purported problem, some states, including Colorado, Pennsylvania, Michigan, and Virginia, allow sports betting companies to adjust their revenue by deducting unlimited free play and promotional bets from their taxable base.[73] Taxes in all four states make up a much lower proportion of Operator revenue compared to other states.[74] New York allows for a deduction for winnings paid to players; without this deduction, the Operators would have owed a tax of almost seven times what they received in GGR in April 2022.[75]

While Operators favor deductions and exemptions for promotional bets to reduce their tax base, and subsequently the state tax burden, some argue that the modified gross receipts model of taxation creates negative externalities like gambling addiction because Operators are incentivized to provide free promotional bets to get individuals hooked on betting. Another way to tax Operators is by instead levying an excise tax which would not allow deductions, and therefore reduce the incentive for gambling to offset societal costs.[76] Although states have not widely adopted an excise tax model to limit negative externalities, it is not uncommon for states to use tax revenues from sports betting to fund public projects such as education and gambling addiction resources. For example, Ohio legalized sports betting in 2021, enacting a 10% tax on GGR "[f]or the purposes the education needs of this state, funding interscholastic athletics and other extracurricular activities for youth, funding efforts to alleviate problem sports gaming, and defraying the costs of enforcing and administering the law governing sports."[77] Ohio's tax

73. *See* Sam McQuillan, *FanDuel, DraftKings Save Millions on Taxes Thanks to Free Play*, BLOOMBERG TAX (July 1, 2023, 1:46 AM), https://www.bloomberglaw.com/product/tax/bloombergtaxnews/daily-tax-report/X2OD0JDK000000?bna_news_filter=daily-tax-report#jcite [https://perma.cc/M9E7-Q2DQ].

74. *Id.*

75. Jeffery Friedman & Sebastian Iagrossi, *A Review of State Taxation of Sports Betting*, 107 TAX NOTES STATE 42, 42 (2023).

76. *See* Boesen, *supra* note 61.

77. OHIO REV. CODE § 5753.021.

revenue from sports betting will be divided into two funds, the "sports gaming profits education fund" and the "problem sports gaming fund."[78]

There are 38 states, and the District of Columbia ("D.C."), that have legalized sports betting. Of the 39 legal sports betting jurisdictions, 10 states only permit retail sports betting, 26 states and D.C. permit both retail and online sports betting, and 2 states (Tennessee and Vermont) only permit online sports betting, leaving 12 states that do not allow sports betting in any form. It must be noted that just because a state has legalized sports betting does not necessarily mean individuals in that state can begin wagering. Some states, like Vermont and North Carolina, recently passed legislation[79] legalizing sports betting, but have not yet seen sports betting "go live." Additionally, although Florida legalized sports betting and was live for a brief time, litigation has put a pause on sports betting in the Sunshine State.[80] Of course, the states without sports betting do not get to raise tax revenue on the activity, and citizens of those states may look to travel to neighboring ones to place their bets. For example, Kansas allows sports betting, but neighboring state Missouri does not and the two already have a history of fighting a sometimes-bitter border war.[81] Unfortunately for Missouri, their border war also includes Iowa, Illinois, and Arkansas, all states that allow sports betting, so the pressures to legalize sports betting may be particularly high. Kentucky is similarly surrounded by neighboring states that have legal sports betting in one form or another. Of course, this border war phenomenon is not exclusive to sports betting, though it is nonetheless noteworthy.

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78. *Id.* § 5753.031 (roughly 98% of the tax revenue from sports betting is designated for education with the remaining 2% going broadly towards combating gambling addiction).

79. Matthew Pertz, *North Carolina Governor Signs Bill to Legalize, Tax Sports Gambling*, TAX NOTES (Jun. 16, 2023) (citing H.B. 347, 2023 Gen. Assemb. (N.C. 2023)), https://www.taxnotes.com/tax-notes-today-state/legislation-and-lawmaking/north-carolina-governor-signs-bill-legalize-tax-sports-gambling/2023/06/16/7gw7z [https://perma.cc/LB3N-9ED7]; *see also* Benjamin Valdez, *Vermont Enacts Bill to Legalize, Tax Sports Betting*, TAX NOTES (Jun. 16, 2023), https://www.taxnotes.com/tax-notes-today-state/excise-taxes/vermont-enacts-bill-legalize-tax-sports-betting/2023/06/16/7gw9s [https://perma.cc/SFC2-SE9B] (citing H.B. 127, 2023 Gen. Assemb. (Vt. 2023)).

80. *See infra* Section IV.C (discussing Florida's legal hurdles with sports betting).

81. Billy Hamilton, *A Sports Betting Border War*, TAX NOTES (Mar. 21, 2023), https://www.taxnotes.com/tax-notes-today-state/gross-receipts-tax/sports-betting-border-war/2023/03/21/7fzk7 [https://perma.cc/DJP2-W5DR].

IV. CURRENT CHALLENGES TO TAXING SPORTS BETTING

Some states have had a challenging time trying to legalize, regulate, and tax sports betting due to the political pressures of their citizens, Operators, Native American tribes, political lobbying groups, and more. The primary challenges to the taxation of sports betting are the potential issues with nexus (discussed further below) if sports betting were to shift towards a federalized or alternatively broadened interstate structure; some states adopting a two-tiered tax structure that may run afoul of ITFA; and tribal compacts that can affect whether a state raises money from sports betting through revenue-sharing with tribes or by taxation of Operators.

A. Nexus and Sourcing of Sports Betting

For states to have the legal authority to levy a tax against a company, Operators included, the state must have nexus, or a certain level of connection between the state and business. The Supreme Court's decision in *Wayfair* represented a departure from the physical presence requirement for determining tax nexus; *Wayfair* eliminated the requirement that a seller have physical presence in the taxing state to be able to collect and remit sales taxes to that state, instead looking to a broader "economic nexus" determination.[82] State economic nexus legislation generally requires an out-of-state seller to collect and remit sales tax once the seller meets a certain level of sales activity within the state. *Wayfair* expanded a state's ability to tax companies that previously would not have been treated as operating within that state under the Supreme Court's prior holding in *Quill*.[83] The *Quill* majority concluded that the physical presence rule was necessary to prevent undue burdens on interstate commerce, but as the internet expanded interstate retail operations beyond what was feasible in 1992, *Quill*'s physical presence requirement created both an inefficient "online sales tax loophole" that gives out-of-state businesses an advantage and was appropriate for the nineteenth-century but not the twenty-first.[84]

Two key distinctions can be made about the state tax treatment of Operators. First, the Wire Act still effectively imposes a physical nexus determination because without in-state bettors, the in-state Operator has no

82. *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018).

83. *See generally id.*

84. *Id.* at 2092 (citing Walter Hellerstein, *Deconstructing the Debate Over State Taxation of Electronic Commerce*, 13 HARV. J. OF L. & TECH. 549, 553 (2000)).

economic activity within a given state. Second, states generally levy a gross receipts tax on Operators, as opposed to a sales and use tax which is generally the preferred taxation method for companies operating e-commerce on an interstate basis. While the shift to economic nexus represents an expansion of states' abilities to collect taxes on interstate commerce, as opposed to relying on mere physical presence of sellers within the state, so long as sports betting remains a purely intrastate activity, economic nexus and physical presence are effectively the same. In other words, all the Operators' revenue attributable to State X is sourced to individuals within State X's borders when the bets were placed, regardless of whether the bets were placed online or at a retail location.

Although the current state of sports betting is regulated on a state-by-state basis, aside from a few scattered federal laws and the federal excise tax, it should be considered what an interstate or federalized sports betting market would look like. Naturally, the rationale for allowing sports betting nationwide is to tax it, but that is where the calculation becomes far more complicated. The most reasonable way to achieve a national sports betting industry is to repeal the Wire Act to allow for interstate sports betting. This would allow Operators to launch a singular, national sportsbook and give individuals the ability to place bets anywhere by simply accessing the internet. This would not automatically create nationwide betting because states may still prohibit sports betting within their borders. Additionally, interstate sports betting would create a more complex tax nexus determination because without looking solely to the physical presence of bettors at the time they place their bets with their respective in-state Operator, the complexity of determining nexus for taxing the Operator increases, as economic nexus could theoretically be any (or all) of the following locations for a single sports bet: the venue of the sports game(s), the location of the sportsbook's server, and the location of the bettor.[85]

DraftKings, for example, offers mobile sports betting via a mobile application and website and since DraftKings is not primarily a casino, it partners with brick-and-mortar locations nationwide to offer sports betting in retail locations.[86] In both retail and mobile circumstances, it is relatively easy for a company like DraftKings to tally their tax burden in each state because

85. *See supra* Section IV.A.

86. *See generally Sportsbook Partners*, DRAFTKINGS SPORTSBOOK, https://sportsbook.draftkings.com/casino-partners-sb [https://perma.cc/C8L6-NDJS].

there is no apportionment between states.[87] It needs to only calculate the GGR from in-state retail locations and mobile bets placed by individuals within that state, which is already a prerequisite for placing bets online to maintain compliance under the Wire Act. However, if individuals could legally place their bets in every state via the Internet or mobile application, how can the states determine tax nexus? The answer is unclear, but one potential, albeit unexplored, workaround to the Wire Act's prohibition against interstate sports betting may be utilizing a multi-state or multijurisdictional sports betting compact.[88]

A multi-state sports betting compact could be signed by several states to allow bettors to participate in betting pools or play DFS with participants in the other signatory states.[89] Other gambling activities, like poker, have already made use of multi-state betting compacts, most notably, the Multi-State Internet Gaming Agreement ("MSIGA").[90] On February 25, 2014, Delaware and Nevada signed the MSIGA, authorizing poker players in one state to compete against players from the other while remaining in their respective states.[91] Since the MSIGA was signed, other states like New Jersey and Michigan have signed on as parties to the agreement, and as other states begin passing legislation to allow online poker, it seems entirely possible that the MSIGA will add member states to its agreement.[92] While this

87. Apportionment is the process of determining how much a business's income is attributable to a state for state income tax purposes. For businesses that operate on an interstate level, they must calculate their earnings in each state to satisfy each state's income taxes. *See What Is State Tax Apportionment and How Do You Calculate It?*, THOMSON REUTERS (Oct. 6, 2021), https://tax.thomsonreuters.com/blog/state-tax-apportionment-calculate-it/ [https://perma.cc/E683-JN2B].

88. *See generally* Andrew D. Appleby & Tomer S. Stein, *Multistate Business Entities*, 55 ARIZ. STATE L. J. (forthcoming 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4284247 [https://perma.cc/BEQ7-QQWE].

89. Because DFS exists in a sort of gray-area of the law, this already exists in large part with no real consequences. For example, Florida does not permit sports betting, and neither legalized nor explicitly made illegal participation in DFS.

90. Multi-State Internet Gaming Agreement, Del.-Nev., Feb. 25, 2014, https://governor.delaware.gov/docs/MultistateInternetGamingAgreement140224.pdf [https://web.archive.org/web/20170108102320/http://governor.delaware.gov/docs/MultistateInternetGamingAgreement140224.pdf].

91. *Id.*

92. *Michigan Signs Multijurisdictional Poker Agreement Allowing Internet Players to Compete Across State Lines*, MICHIGAN GAMING CONTROL BOARD (May 23, 2022), https://

multijurisdictional compact model could be used by states to allow for interstate sports betting, DFS, and other sports betting games, no states have seriously considered a multi-state sports betting compact.[93] The main legal hurdle to this model would be the Wire Act, which currently does not look to the legality of sports betting in a particular state to constitute a violation. It is possible that in a case where the government brought a criminal charge against an Operator, the prosecution would contend that the legality of sports betting in a state or the existence of a multi-state betting compact between several states would not provide a valid defense to charges under the Wire Act. The *Murphy* Court alluded to this problem, without necessarily resolving it, stating:

> Under § 3702(2) [PASPA], private conduct violates federal law only if it is permitted by state law. That strange rule is exactly the opposite of the general federal approach to gambling. Under 18 U.S.C. § 1955 [the Illegal Gambling Business Act], operating a gambling business violates federal law only if that conduct is illegal under state or local law. Similarly, 18 U.S.C. § 1953 [the Interstate Transportation of Gambling Paraphernalia Act], which criminalizes the interstate transmission of wagering paraphernalia, *and 18 U.S.C. § 1084 [the Wire Act], which outlaws the interstate transmission of information that assists in the placing of a bet on a sporting event, apply only if the underlying gambling is illegal under state law*. . . These provisions implement a coherent federal policy: They respect the policy choices of the people of each State on the controversial issue of gambling.[94]

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www.michigan.gov/mgcb/news/2022/05/23/multijurisdictional-poker-agreement-signed [https://perma.cc/Y9CS-FGSE]; *see also* Multi-State Internet Gaming Agreement, *supra* note 90.

93. *But see* Nicholaus Garcia, *Interstate Sports Betting Compacts? Ohio Lawmaker Pitches Them at DC Summit*, LEGAL SPORTS REPORT (Nov. 15, 2018), https://www.legalsportsreport.com/25941/awmaker-suggest-interstate-sports-betting-compacts/ [https://perma.cc/PMA8-2YQA] (reporting that Ohio state senator Bill Coley brought up the idea of a multi-state sports betting compact at the US Sports Betting Policy Summit in 2018); Dustin Gouker*, Feds Would Have to Approve Sports Betting Laws Under New Draft Bill in Congress*, LEGAL SPORTS REPORT (Dec. 4, 2018), https://www.legalsportsreport.com/26545/federal-sports-betting-bill-2018/ [https://perma.cc/8JEY-Z3QK] (reporting that an early draft of a federal sports betting bill circulated by Senator Hatch included a proposal to allow interstate sports wagering compacts to be entered into by states and tribes, subject to approval by the Attorney General, but this bill never reached a final form).

94. Murphy v. NCAA, 138 S. Ct. 1461, 1483 (2018) (emphasis added).

The Supreme Court appears to suggest, albeit in dicta, that each of these federal gambling laws, including the Wire Act, requires an underlying violation of state law. If the Wire Act is interpreted in this fashion, states have a strong argument that a multi-state sports betting compact does not run afoul of the Wire Act and could provide the framework for this limited type of interstate sports betting. In such a case, states would need to formulate a way to tax these bets. The most likely structure would be based on an apportionment formula where states continue to tax the Operator's GGR, but are limited to taxing the amount sourced to in-state bettors, based on the bettors' physical presence.

B. The Internet Tax Freedom Act

There appears to be no correct answer to the question, "How should the digital economy be taxed?" The Internet Tax Freedom Act ("ITFA") was enacted as a temporary measure in 1998 and made permanent in 2016.[95] ITFA prohibits three types of taxes: (1) taxes on internet access; (2) discriminatory taxes on electronic commerce; and (3) multiple taxes on electronic commerce.[96] When Congress decided to make ITFA permanent, the House Judiciary Committee provided insight into the legislative intent of ITFA, and to what extent at least some aspects of ITFA were no longer appropriate.[97] The second provision, the anti-discrimination provision, was intended "to prevent the potential stifling of the Internet and to foster the growth of electronic commerce," and in effect prohibits differential tax treatment of essentially identical transactions, except that one is made online.[98]

Much of the case law surrounding the anti-discrimination provision of ITFA relates to businesses that conduct sales over the internet, whereby a

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95. Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Pub. L. No. 105-277, Tit. XI, 112 Stat. 2681, 719, 1 *amended by* Pub. L. 107-75, § 2, 115 Stat. 703 (2001); Internet Tax Nondiscrimination Act of 2004, Pub. L. No. 108-435, §§ 2-6A, 118 Stat. 2615-2618, 1 (2004); Internet Tax Freedom Act Amendments Act of 2007, Pub. L. No. 110-108, §§ 2-6, 121 Stat. 1024-1026, 1 (2007); Consolidated and Further Continuing Appropriations Act of 2015, Pub. L. 113-235, Pub. L. No. 113-235, § 624, 128 Stat. 2377, 1 (2015); Trade Facilitation and Trade Enforcement Act of 2015, Pub. L. No. 114-125, § 922, 130 Stat. 281, 1 (2015) (codified at 47 U.S.C. § 151 note).

96. *See* Walter Hellerstein & Andrew Appleby, *The Internet Tax Freedom Act at 25*, 107 TAX NOTES STATE 7, 8 (2023); *see also* Internet Tax Freedom Act, 47 U.S.C. § 151 note (Moratorium on Internet Taxes, § 1101(a)).

97. *See* H.R. REP. NO. 113-510, at 5-9 (2014).

98. *Id.* at 17.

seller commonly challenges a state's sales tax as violating ITFA because ITFA imposed restraints on the states' power to require remote sellers to collect use taxes on their online sales.[99] The cases frequently turn to a discussion on nexus. The ITFA's minimum nexus provision forbids states from imposing taxes on internet sales by remote sellers if the state relies on the purchaser's sole ability to access the seller's out-of-state computer server as a factor in determining whether the remote seller has nexus with the state and, consequently, an obligation to collect a tax on the transaction.[100] While the litigation before the Supreme Court of Maryland fell short of providing what could have been a crucial interpretation of ITFA's anti-discrimination provision, both the trial court's analysis and briefs filed on appeal provide insight for future challenges in states that impose a higher rate on online sports betting than retail sports betting, which appear to run afoul of ITFA.

1. Maryland's Digital Advertising Tax & ITFA

Maryland's digital advertising tax ("DAT") may reflect a new approach to taxing electronic commerce.[101] In February 2021, Maryland was the first state in the nation to enact a tax on digital advertising.[102] The tax was supposed to be imposed on "annual gross revenues of a person derived from digital advertising services in the State."[103] But by April of the same year, seven divisions of Comcast and Verizon Media Inc. filed a lawsuit in a Maryland Circuit Court challenging Maryland's DAT on constitutional grounds, as well as under ITFA.[104] The constitutional arguments in *Comcast* involve the Commerce Clause, 10th Amendment anti-commandeering principles, and even the 1st Amendment; however, those arguments are likely of little relevance to the legal analysis applicable to Operators or states' sports betting

99. *See* Hellerstein & Appleby, *supra* note 96, at 12.

100. *Id.*

101. *Id.* at 11-12.

102. MD. CODE ANN., TAX-GEN. § 7.5-101 et seq. (effective Jan. 1, 2022); *see also* Kathleen Saunders Gregor, *Taxpayers (and States) Take Notice: Invalidation of the Maryland Digital Advertising Tax Highlights the Importance of the Internet Tax Freedom Act in SALT Litigation*, JD SUPRA (Nov. 1, 2022), https://www.jdsupra.com/legalnews/taxpayers-and-states-take-notice-1840676/ [https://perma.cc/PAL4-PE2Z].

103. TAX-GEN. § 7.5-101.

104. Comptroller of Md. v. Comcast LLC, 294 A.3d 1108, 1109 (Md. 2023).

taxes. It is worthy to note that the Comptroller's argument in *Comcast* is that ITFA is unconstitutional because it violates the anti-commandeering doctrine applied in *Murphy*, and some commentators see *Murphy* as a route for ITFA to be struck down as commandeering.[105] However, there is more support for the argument that ITFA is a preemption statute; ITFA preserves state and local governments' enforcement of their taxes, except as to the protected activity relating to interstate e-commerce.[106] Before reaching the commandeering question, the *Murphy* Court explained that PASPA was not a preemption statute because Congress had no constitutional authority to enact the law regulating intrastate gambling and the Supremacy Clause alone is not a grant of authority.[107] The *Murphy* Court made the federalism balance for sports betting clear, writing, "Congress can regulate sports gambling directly, but if it elects not to do so, each State is free to act on its own."[108] While *Murphy* was the case that permitted sports betting to be legalized by states, sports betting was not the subject matter of the *Comcast* litigation before the Maryland Supreme Court.

The Maryland Circuit Court for Anne Arundel County granted the taxpayers' motion for summary judgment, invalidating the digital advertising tax on several grounds, including ITFA as "the [DAT] constitutes a discriminatory tax."[109] Judge Asti ruled that taxing digital advertising while not taxing other advertising amounts to discrimination under ITFA, stating in a hearing on the matter: "puppies are puppies, and advertising is advertising."[110] But, in a per curiam order, the Maryland Supreme Court vacated the circuit court's opinion, remanding the case with directions to dismiss the

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105. Matthew A. Melone, *Murphy v. NCAA and South Dakota v. Wayfair, Inc.: The Court's Anticommandeering Jurisprudence May Preclude Congressional Action with Respect to Sales Taxes on Internet Sales*, 67 DRAKE L. REV. 413, 415-16 (2019).

106. *See* Jeffrey Friedman & Alla Raykin, *Congress's Preemption of State Tax Laws Is Not Commandeering*, 101 TAX NOTES STATE 1085, 1085-86 (Sept. 6, 2021).

107. Murphy v. NCAA, 138 S. Ct. 1461, 1479 (2018).

108. *Id*. at 1484-85. *see also id.* at 1489 (Ginsburg, J., dissenting) (stating that there is not "any doubt that Congress has power to regulate gambling on a nationwide basis").

109. *Murphy*, 138 S. Ct. at 1484-85.

110. Billy Hamilton, *In Maryland, Puppies Are Puppies and Ads Are Ads, Apparently*, TAX NOTES (Oct. 31, 2022), https://www.taxnotes.com/tax-notes-state/digital-economy/maryland-puppies-are-puppies-and-ads-are-ads-apparently/2022/10/31/7f8zg?highlight=Billy%20Hamilton [https://perma.cc/B5NE-YU75].

action, thereby upending Comcast's challenge to the Maryland DAT.[111] Although the court did not address the merits of the case, instead dismissing on procedural grounds because Comcast failed to exhaust its administrative remedies before bringing the challenge in state court, the relevant analysis in the briefs filed can still provide insight into the ITFA issues.[112]

In an amici brief filed on March 31, 2023, several tax law professors argued the Supreme Court of Maryland should reverse Judge Asti's decision because the DAT does not violate ITFA for three reasons.[113] First, "similarity" for purposes of ITFA preemption requires a substantive analysis.[114] Second, digital advertising is used differently, has a significantly different impact, and relies on a business model that is deeply and fundamentally different from non-digital advertising and is thus not "similar" under the ITFA.[115] Finally, discrimination presupposes treating one similar transaction worse than another, but Maryland's DAT merely taxes aspects of commerce that are currently untaxed in ways applicable to non-digital goods and services.[116] The brief cites to *Labell v. City of Chicago*, where the Illinois Appellate Court held that Chicago's "Netflix tax" on streaming services was not a discriminatory tax because there were no comparable services that did not involve electronic commerce.[117] In *Labell*, the court concluded that there were substantive differences in the usage of streaming services that made them not "similar" to purported non-digital analogs like video machines, jukeboxes, and live performances.[118] The brief also cites to *Gartner, Inc. v. Dep't of Revenue*, where the Washington Court of Appeals rejected the argument that levying a sales tax on subscriptions to an online research library constituted a discriminatory tax under ITFA because the tax did not apply to

111. Comptroller of Md. v. Comcast LLC, 294 A.3d 1108, 1109 (Md. 2023).

112. *Id.*

113. Brief of Amici Curiae Tax Law Professors at 5-14, 21, Comptroller of Md. v. Comcast LLC, 294 A.3d 1108 (Md. 2023) (No. C-02-CV-21-000509) [hereinafter, the "Tax Law Professors' Brief"].

114. *Id.* at 5-7.

115. *Id.* at 6.

116. *Id.* at 14.

117. *Id.* at 5-6 (citing Labell v. City of Chicago, 147 N.E.3d 732 (Ill. App. 2019)).

118. *Id.* at 6 (citing *Labell*, 147 N.E.3d at 743, 747-48).

physical deliveries of research reports.[119] Accordingly, the brief asserts digital advertising is not similar to traditional advertising because "digital advertisers are not buying access to a billboard or to a corner of a magazine page like traditional advertisers; they are, quite literally, buying access to *you*, from companies who have harvested data from their other business lines to build a precise profile of who *you* are."[120] The brief also attempts to clarify what is considered "substantially similar" in analyzing ITFA's anti-discrimination provision by citing to the Supreme Court's holding in *Gen. Motors Corp. v. Tracy*, where the Court held that "products that are merely superficially comparable are not 'similar' for purposes of a discriminatory taxation analysis."[121]

The Appellees in the case filed a brief on April 14, 2023, in response to the Tax Law Professors' Brief, arguing that the Professors' ITFA analysis is legally incorrect, particularly where the Professors argue against the similarity of digital and non-digital advertising:

> Although digital and non-digital advertising *are* fundamentally similar, the argument in the Professors' brief fails for an even more fundamental reason. As Appellees explained in their brief responding to the Comptroller, the argument is based on a misreading of ITFA. ITFA's definition of "discriminatory tax" does not require a plaintiff to show that there is something "similar," only that there is no tax on anything that is 'similar'… Because the DAT applies *only* to electronic commerce, it does not apply to *any* non-electronic commerce transactions, whether 'similar' or not. Therefore, by definition, the DAT is a discriminatory tax… The Professors do not offer any analysis of the text of the statute to contradict this plain-language conclusion.[122]

The Appellees' brief also argues that Maryland's tax was distinguishable from other taxes that had been held not to violate the ITFA, including

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119. *Id.* (citing Gartner Inc. v. Dep't of Revenue, 455 P.3d 1179, 1192-93 (Wash. App. 2020)).

120. *Id.* at 10 (emphasis in original).

121. *Id.* at 7 (citing Gen. Motors Corp. v. Tracy, 519 U.S. 278, 279, 299 (1997)).

122. Brief of Appellees Responding to Amici Curiae Brief of Tax Law Professors at 7, Comptroller of Md. v. Comcast LLC, 294 A.3d 1108 (Md. 2023) (No. C-02-CV-21-000509) (emphasis in original).

Labell, because the expansion of Chicago's amusement tax to streaming services was generally applicable to both online and offline transactions, unlike Maryland's DAT that is targeted solely at e-commerce.[123] A decision on the merits could have been particularly important, for example in trying to determine further what a "similar'' good or service is pursuant to ITFA's anti-discrimination provision, which would certainly add context to the arguments in determining the legality and validity of the two-tiered tax structure in states' sports betting tax regimes. However, the only tangible outcome following the *Comcast* appellate decision is that bringing a challenge to a DAT will be much lengthier and more burdensome for taxpayers, who now must exhaust their administrative remedies before bringing their claim to court.

2. Sports Betting Under ITFA

Most states that allow sports betting impose a single tax rate on Operators. Other states impose a two-tiered system, in which the state taxes wagers made online at a higher rate than bets placed in-person at retail locations. While a two-tiered taxation structure on sports betting seems to violate ITFA as it is a discriminatory tax on electronic commerce, there have not been any cases brought forth by Operators to challenge such a tax structure. It seems plausible that a state court could hold a state's two-tiered taxation structure on sports betting to violate ITFA, and six states are vulnerable to such a challenge.[124]

123. *Id.*

124. *See infra* Table 2.

TABLE 2
STATES WITH TWO-TIERED TAXES ON SPORTS BETTING

STATE	TAX RATE	
	RETAIL	ONLINE
ARIZONA [125]	8%	10%
LOUISIANA [126]	10%	15%
MASSACHUSETTS [127]	15%	20%
NEW HAMPSHIRE [128]	50%	51%
NEW JERSEY [129]	9.75%	14.25%
NEW YORK [130]	10%	51%

In general, the ban on discriminatory taxes means that the same tax obligations and tax rates must apply to electronic commerce and non-electronic commerce transactions involving the same or similar product. To illustrate this issue, consider the following hypothetical:

> Amy visits New York for the big Browns game against the Jets. While there, she visits the local casino and sportsbook, BigSportsbook, and decides to place a $500 bet on the Browns. A few hours later, she drives to the stadium to watch the game and thinks, "I should have put more money on the Browns, I've got a good feeling about today," and continues to place another $500 bet from her cell phone, using the BigSportsbook mobile application. The Browns lose, and so does Amy.

125. ARIZ. ADMIN. CODE § 19-4-112 (2023).

126. LA. STAT. ANN. § 27:625 (2021).

127. MASS. GEN. LAWS ch. 23N, § 14(a) (2022).

128. Executive Council of New Hampshire, Governor and Executive Council Agenda (Nov. 25, 2019), https://sos.nh.gov/media/uzajvrsj/gc-agenda-112519-print.pdf [https://perma.cc/X94A-7THP].

129. N.J. REV. STAT. § 5:12A-16 (2019).

130. N.Y. RAC. PARI-MUT. WAG. & BREED. LAW § 1367(7) (McKinney 2021).

> BigSportsbook gets to keep the $1,000 that Amy wagered, so the GGR on Amy's wagers, assuming no deductions apply, is $1,000. Because New York imposes a 10% tax on retail bets, and a 51% rate on online bets, BigSportsbook will need to pay $305 in taxes on Amy's two bets, broken down to $255 for the mobile bet and $50 for the retail bet.
>
> BigSportsbook *could* claim that offering retail and betting constitutes substantially similar services because the only difference, practically speaking, is the available location of the bettor, but the service or product itself does not fundamentally change; therefore, the state imposing a 41% higher tax rate on mobile betting constitutes a discriminatory tax under ITFA.

Imposing a higher rate on online betting than retail betting appears to, at least facially, constitute some degree of discrimination because it explicitly targets online sports betting. ITFA defines a "discriminatory tax" as "any tax imposed by a State … on electronic commerce that … is not generally imposed … *at the same rate* by such State … on transactions involving similar property, goods, services, or information."[131] A strong argument can be made that retail and online betting involve similar services because when an Operator, for example, sets the moneyline on a sporting event, those odds are available to bettors in both the Operator's retail and online platforms. A distinction can be made that odds are frequently subject to change, and theoretically, an Operator may set the odds differently at a retail location than over the internet, perhaps to drive foot-traffic for other brick-and-mortar commerce such as bars, restaurants, and other forms of entertainment. In such a case, an argument can be made that retail and online betting does not involve similar information under ITFA. This exemplifies the fact-specific nature that may be involved in a future challenge and depending on the circumstances with an Operator's specific business model or oddsmaking practices, the ITFA analysis could vary.

While the Maryland Supreme Court dismissed Judge Asti's ruling in *Comcast*, it did so on procedural grounds rather than on the merits. Consider a situation where an Operator in a state with a two-tiered tax rate on sports betting sues the state for violating ITFA's anti-discrimination clause. A reviewing court could find that the higher rates on online betting violate ITFA because, following Judge Asti's logic from the *Comcast* hearing, puppies are

131. 47 U.S.C. § 151 note (Internet Tax Freedom Act) (emphasis added).

puppies and gambling is gambling.[132] In other words, there is no practical difference between placing a wager on a sporting event in-person at a casino or sportsbook and at home from a mobile betting app. A distinction can be made, however, that Maryland's DAT is imposed only on digital ads with no such tax on traditional advertising, whereas the two-tiered sports betting taxes that currently exist simply tax online betting at a higher rate but do not forego taxing the retail bets altogether. Certainly, if a state taxed online sports betting without also imposing some tax on retail betting, an Operator would have a much stronger argument that the tax constitutes discrimination like the Appellees' arguments in *Comcast*. Because there have yet to be any successful challenges, Maryland's digital advertising tax is still enforceable, and it remains to be seen whether a state court will invalidate such a tax as running afoul of ITFA, leaving uncertainty as to the legality of a two-tiered sports betting tax structure.

It should also be noted that currently, there are several states that permit retail sports betting but have not yet legalized online sports betting.[133] In those states, there is no argument that there is a discriminatory tax on sports betting under ITFA because without an alternative to retail betting, there is no similar good or service subject to the discriminatory taxation. Likewise, in Tennessee and Vermont, which only permit online sports betting, there is no discrimination against e-commerce because there is simply no retail alternative, or "similar service" in that state.[134]

It is also possible that the Wire Act may be a state's best shield against an ITFA challenge. The cases interpreting ITFA's anti-discrimination provision are largely relating to taxes on internet activity that implicate interstate activity, but because the Wire Act prohibits interstate sports betting, there simply are not the same challenges.[135] Therefore, a state defending its higher taxes on online sports betting compared to the retail alternatives may argue that a higher tax on online sports betting does not violate ITFA because it

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132. *See* Hamilton, *supra* note 110.

133. Delaware, Mississippi, Montana, New Mexico, North Dakota, South Dakota, Washington, and Wisconsin.

134. TENN. CODE ANN. § 4-49-101 (2022) (transferred from § 4-51-301); SPORTS WAGERING ACT, ch. 25, 2023 Vt. Laws 63.

135. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (the Court will sustain a tax so long as it (1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides).

does not discriminate against interstate commerce. There are a few issues with this legal argument. First, this argument may go against the legislative intent of ITFA, which clearly indicates a desire to protect electronic commerce.[136] Second, the argument incorrectly conflates ITFA with the dormant Commerce Clause, because the motivation to protect interstate commerce is not found in the text of ITFA's anti-discrimination prong.[137] Finally, from a litigation strategy perspective, it may be unwise for an Operator to use the Wire Act to challenge a state's two-tiered tax structure while also pushing for its repeal or amendment to allow interstate betting. While the purposes of either attacking or supporting the Wire Act vary depending on the context of the argument, courts and legislators may just tell the Operators, "you can't have your cake and eat it too." While delving into the litigation strategy behind an ITFA challenge extends beyond the scope of this Article, it is worth mentioning because the foreseeable cases involving sports betting will not exist in a vacuum.

C. Tribal Compacts

A few states, like Florida, face a unique challenge to legalizing sports betting: tribal compacts. In fact, two of the country's most populous states, California and Florida, have an uphill battle with legalizing sports betting, in large part due to tribal compacts.[138] The issue these states face is the fact they cannot tax tribes as sovereign nations; however, the Indian Gaming Regulatory Act ("IGRA") enables states and tribes to instead enter into gaming compacts to share revenues.[139] Because a revenue-sharing model is the only viable way for states to reap the benefits of allowing sports betting to exist exclusively on tribal lands, and because many tribes nationwide already

136. H.R. REP. NO. 113-510, at 5-10 (2014).

137. 47 U.S.C. § 151 note (Internet Tax Freedom Act).

138. This Article provides a brief analysis of Florida's tribal compact for sports betting. For California, *see* Daniel Wallach, *A Legislative Path for Sports Betting in California: An Examination of Hotel Employees and the California Supreme Court's Dueling Interpretations of the Constitutional Ban on "Casino-Style' Gaming*, 25 CHAP. L. REV. 171, 178-79 (2021) (explaining the primary stakeholders in California are tribal casinos, commercial gambling companies and card rooms, and state-regulated horse racetracks. California's Native American tribes view sports betting as a vehicle to increase visitation to tribal casinos, many of which are located in rural areas, and there is concern that the widespread availability of mobile sports wagering throughout the state would reduce incentives to visit such facilities).

139. *See* John Holden & Kathryn Kisska-Shulze, *Taxing Sports*, 71 AM. U. L. REV. 845, 896 n.348 (2020); *see also* Indian Gaming Regulation, 25 U.S.C. § 2701 (1988).

hold a dominant position in the gambling market, tribes have significant leverage over states and have proven to be a roadblock in states' efforts to legalize sports betting.

In 2021, Florida Governor Ron DeSantis signed a compact with the Seminole Tribe of Florida (the "Compact"), and after a default approval[140] by the Secretary of the Interior, the Compact became law and effectively granted the Seminole Tribe a monopoly over both online and retail sports betting.[141] Several betting companies, concerned about the monopolization of the Florida sports betting market, filed a lawsuit to vacate the Compact, claiming it was utilizing the IGRA to circumvent Florida state law, which requires voter approval, and that the Compact was in violation of the IGRA.[142] The lawsuit made its way to the D.C. District Court, where Judge Friedrich set aside the Compact, holding that it violated the IGRA, which mandates that any gaming activities authorized under a tribal-state compact occur only "on Indian lands."[143] The Compact aimed to permit online sports betting throughout the entire state by placing the Tribe's sportsbook servers on reservation land.[144] The Florida Senate Bill to enact the compact read as follows:

> Wagers on sports betting, including wagers made by players physically located within the state using a mobile or other electronic device, shall be deemed to be exclusively conducted by the Tribe where the servers or other devices used to conduct such wagering activity on the Tribe's Indian lands are located.[145]

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140. The Secretary of the Interior, Deb Haaland, received a copy of the Compact in June 2021, but by taking no action in 45 days, the Compact was approved by default. 2021 Gaming Compact Between the Seminole Tribe of Florida and the State of Florida, Fla.-Seminole Tribe of Fla. Apr. 25, 2021, https://www.flgov.com/wp-content/uploads/pdfs/2021%20Gaming%20Compact.pdf [https://perma.cc/8HEB-LSCU].

141. *See* W. Flagler Assocs., Ltd. v. Haaland, 573 F. Supp. 3d 260, 264 (D.D.C. 2021); *see also id.* at 15, 20.

142. *W. Flagler Assocs., Ltd.*, 573 F. Supp. 3d at 263.

143. *Id.* at 272; *see also* Tribal Gaming Ordinances, 25 U.S.C. § 2710(d)(8)(A).

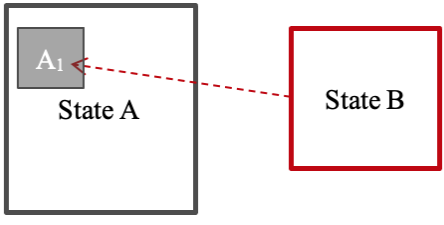
144. *Id.* at 273.

145. S.B. 2A, 123rd Leg., Spec. Sess. A (Fla. 2021).

Judge Friedrich vehemently rejected the idea that the Compact's language could create what was effectively a nexus loophole, writing, "although the Compact 'deem[s]' all sports betting to occur at the location of the Tribe's 'sports book(s)' and supporting servers, this Court cannot accept that fiction."[146] While the Compact was vacated pursuant to federal law under the IGRA, there were clear concerns noted by the court regarding the legality of the Compact under state law.[147] In *Flagler*, the trial court found that the reliance on Florida law to defend the Compact "misses the mark" because the agreement authorizes gaming off and on Indian lands.[148] This decision was appealed by the Department of Interior and the Seminole Tribe of Florida, who challenged separate issues with Judge Friedrich's decision.

Florida's attempt to consolidate the statewide economic activity – individuals' wagers anywhere in the state – at one singular location can be considered a type of hub-and-spoke model of creating a singular nexus, which has not been generally accepted in the state and local tax field.[149]

DIAGRAM 1



Sports betting is legal in State A, but only through an agreement that all sports betting will be conducted at an Operator on tribal

146. *W. Flagler Assocs., Ltd.*, 573 F. Supp. 3d at 273 (emphasis added).

147. *Id.* at 275 (citing FLA. CONST. art. X, § 30 (a)-(c), which provides that "casino gambling" may only be authorized pursuant to a vote by citizens' initiative or through an IGRA compact, and defines "casino gambling" as meaning "any of the types of games typically found in casinos and that are within the definition of Class III gaming in [IGRA]," including as defined in 25 C.F.R. § 502.4, which expressly includes "any sports betting" within the definition of "Class III gaming." The amendment excludes from its definition of "casino gambling" three specific activities: pari-mutuel wagering on horse racing, dog racing, and jai alai exhibitions).

148. *Id.*

149. *See infra* Diagram 1.

> land within the state (A_1). Under the hub-and-spoke model of nexus, an individual in State A who is not physically present at A_1 may still place bets through A_1's Operator via Internet access or mobile application since the Operator's servers are located at A_1. The economic activity for determining nexus, the wager, will be deemed to have taken place *only* at A_1.
>
> It stands to reason that an individual in State B could also place a bet through the A_1 Operator because their economic activity is also deemed to only take place at A_1 based solely on the fact that it was an internet-based transaction, and the Operator's servers are still at A_1. While this transaction would seemingly violate the Wire Act's prohibition against interstate sports betting, exposing the Operator at A_1 to prosecution by accepting interstate wagers, the Operator would argue that there was *not* an interstate transaction because the economic activity was solely at A_1, much like how the economic activity from bettors in State A is deemed to take place at A_1 regardless of the bettor's location.

Suppose this model were to be accepted for sports betting, whereby the physical location of bettors is irrelevant and the sportsbook's server location is the only place where sports betting must be legal. In that case, it is unclear how this could be managed in an interstate context without violating the Wire Act. Because this hub-and-spoke model for sports betting is so ripe for abuse, it seems unlikely that states will veer from a physical presence determination. During oral arguments, counsel for the Department of the Interior was asked about the compatibility of federal statutes like the Wire Act and the UIGEA, signaling the court's awareness of these issues.[150] In a brief filed prior to oral arguments, Appellees contend that "any realistic implementation of the Compact would require use of wire facilities operating in interstate and foreign commerce."[151] Online communications are almost "invariably routed between servers in and out of state between their origin and destination."[152] Judge Friedrich's opinion should have prevailed on appeal

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150. *See* John Holden, *Analysis: Florida Sports Betting Compact Case Gets Its Day in Court*, LEGAL SPORTS REPORT (Dec. 15, 2022), https://www.legalsportsreport.com/94108/analysis-florida-sports-betting-compact-case-gets-its-day-in-court/ [http://archive.today/gXabG].

151. *See* Brief of Appellees at *36, W. Flagler Assocs v. Haaland, 71 F.4th 1059 (D.C. Cir. 2023), (Nos. 22-5022, 21-5265).

152. *Id.* at *36-37 (citing Missouri ex rel. Nixon v. Coeur D'Alene Tribe, 164 F.3d 1102, 1109 n.5 (8th Cir. 1999) (holding that lottery based on tribal lands offered over the internet "is not

as a matter of substantive law, but the D.C. Circuit instead overturned the holding of *Flagler* on procedural grounds, as discussed below.

So far, this Article argues that the hub-and-spoke model of determining where the betting activity occurs under the Compact should be rejected, but the D.C. Circuit Court of Appeals disagreed in its June 30, 2023, decision, vacating the trial court decision.[153] But where the court centered its analysis on appeal avoids the bigger issues. The court analyzed the provision of the Compact that provides for the hub-and-spoke model discussed above:

> The Compact does not say that these wagers are 'authorized' by the Compact. Rather, it simply indicates that the parties to the Compact (i.e., the Tribe and Florida) have agreed that they both consider such activity (i.e., placing those wagers) to occur on tribal lands. . . The Compact 'authorizes' only the Tribe's activity on its own lands, that is, operating the sports book and receiving wagers. The lawfulness of any other related activity such as the placing of wagers from outside Indian lands, under state law or tribal law, is unaffected by its inclusion as a topic in the Compact.[154]

Simply put, the court reasoned that the Compact authorized only the Tribe's activity on its own land and the language has no effect on the lawfulness of any other related activity under state law. Because the Plaintiff-Operators in the case objected to the Secretary's decision to allow the Compact to go into effect, the court needed only to decide whether the Secretary's *decision* was lawful, leaving the practical and substantive issues relating to the Compact for the Florida courts to decide.

The court punted on the larger issues relating to the case for one reason: the parties. Neither the Seminole Tribe nor the state of Florida were parties to the litigation in *Flagler*, therefore the D.C. Circuit did not need to opine as to the constitutionality of the Compact under state law. The court held that, "the Secretary's decision not to act on the Compact was consistent with [the] IGRA. In reaching this narrow conclusion, we do not give our

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on Indian lands" when a wager is placed from "off the reservation," and noting "that in the criminal statute prohibiting interstate wagering by wire, Congress's limited exemption for lawful gambling requires that the betting be legal in the State from which the bettor places a call")).

153. W. Flagler Assocs., Ltd. v. Haaland, 71 F.4th 1059, 1072 (D.C. Cir. 2023).

154. *Id.* at 1066.

imprimatur to all of the activity discussed in the Compact. And particularly, for avoidance of doubt, we express no opinion as to whether the Florida statute ratifying the Compact is constitutional [under Florida state law]."[155]

Without reaching a decision on the state law implications of the Compact, the D.C. Circuit wanted to be clear about one thing, "an IGRA compact cannot provide independent legal authority for gaming activity that occurs outside of Indian lands, where that activity would otherwise violate state law." However, it is difficult to understand how the court recognizes that the IGRA cannot authorize wagering off tribal lands, but upholds the Compact which, in practice, does exactly that. Perhaps the court was signaling that this is not the last we hear of the Florida sports betting saga. Short of the U.S. Supreme Court granting certiorari, which is unlikely, the future of sports betting in Florida lies in the hands of the Florida's courts and/or Floridian voters.

If this issue heads to the Sunshine State, fortunately, there is precedent in the Florida judiciary.[156] In 2007, Florida Governor Charlie Crist signed a gambling compact with the Seminole Indian Tribe of Florida to expand gaming on tribal lands.[157] In *Crist*, the Florida Supreme Court held that the Governor did not have the authority to bind the State to a gaming compact that "clearly departs from the State's public policy by legalizing types of gaming that are illegal everywhere else in the state."[158] In a hypothetical (but foreseeable) challenge to the Compact following the *Flagler* litigation in federal court, Florida courts should uphold the precedent from *Crist*. The primary holding of *Crist* was that the Governor cannot unilaterally bind the State to a compact that contradicts state law or violates the state's constitutional separation of powers mandate.[159] Notably, in *Flagler*, the Compact sought to contravene the constitutional requirement of a voter initiative to legalize sports betting by unilateral action implemented by the Governor, which was seemingly unlawful following the holding of *Crist*. Until *Flagler* makes its way through the Florida state courts, the status of sports betting in Florida

155. *Id.* at 1068 (citing FLA. CONST. art. X, § 30 (a)-(c)).

156. *See* Fla. H.R. v. Crist, 999 So. 2d 601 (Fla. 2008).

157. *Id.* at 603.

158. *Id.*

159. *Id.* at 616; *see also* FLA. CONST. art. II, § 3.

remains unclear. What remains true is that the hub-and-spoke model of determining nexus is not a workable solution to states' sports betting woes.

V. CONCLUSION

Operators must ensure that they conduct business exclusively on an intrastate basis in light of the U.S. Department of Justice's sustained, broad interpretation of the Wire Act. Online sportsbooks have solved this issue by implementing a mandatory geolocation feature to ensure bettors' physical presence is within a state that permits sports betting. However, the emerging and growing sports betting industry will continue to push for nationwide acceptance and legalization of sports betting, especially as e-commerce alternatives to their retail counterparts continue to swallow market share. As states continue to legalize sports betting, and states that have already done so regulate and collect taxes from Operators, states need not get creative with administering tax policy for sports betting. Using the physical presence of an individual bettor is the only practical and reliable way to determine the legality and subsequent tax nexus determination of a bettor and Operator, alike.

It is unclear if or when an Operator will challenge a state's two-tiered tax structure under the ITFA. While the plain-text reading of the ITFA makes such a case for an Operator strong, there are valid reasons for Operators to be hesitant to rush to court. For one, the case law under ITFA's anti-discrimination prong is not well developed. Additionally, it is not beyond imagination that Operators lobbied their state legislatures to legalize betting in the first place, occasionally allowing a higher tax rate to allow a bill to pass. Also imaginable is that a challenge to such a tax structure would simply result in the defendant-state simply raising their retail tax rates to match the online rates, which would likely side-step the ITFA challenge and backfire on the plaintiff-Operator who now will face an elevated tax burden in that state. Political lobbying and litigation strategy are likely more influential in predicting whether or not we ever see such a challenge; however, the underlying analysis remains worthwhile. The last remaining option would be a full repeal of the ITFA, which does not appear likely anytime soon.

Finally, the taxation issues presented in this Article are merely a few of the concerns. The social policy concerns over the addictive nature of gambling and the integrity of professional sports remain a priority for both lawmakers and citizens. Proponents of widespread legalization of sports betting advocate that there will be marked reductions in criminal activity, increases in tax revenue to fund various public works, and increased participation in

sports due to the positive relationship between gambling and viewership. One thing seems relatively certain for the foreseeable future: sports betting is here to stay and will continue to grow.