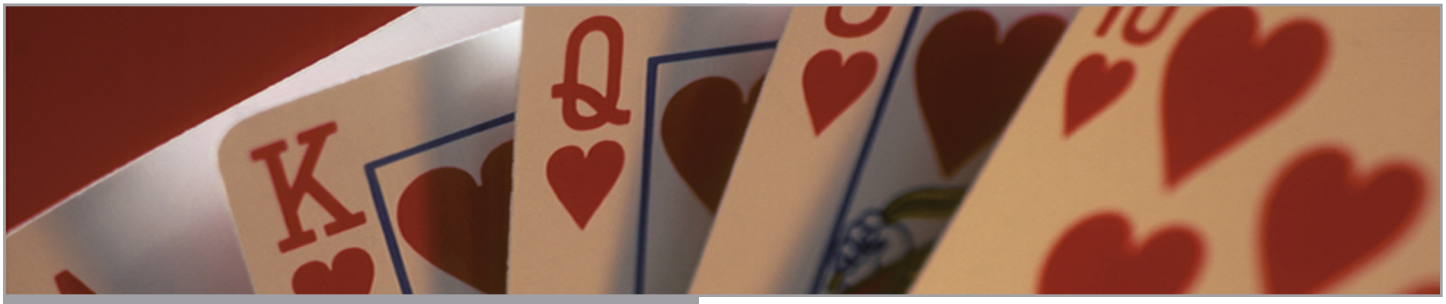
# GAMING**LEGAL**NEWS



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## THE 800-POUND GORILLA LURKING BEHIND THE I-POKER INDICTMENTS – U.S. TAX CONSEQUENCES TO ONLINE PLAYERS

by Peter J. Kulick

Depending on one's perspective of the U.S. i-poker industry, April 15 has been alternatively referred to as "Gold Friday" and "Black Friday." April 15 has long been a dubious day in the United States. The United States has a strong anti-tax history – dating back to the founding of the Republic. Much of the legal commentary has focused on the impact the indictments will have on the i-poker industry in the United States and the prospect that Congress and/or individual state legislatures will authorize i-gaming in the United States. The legal discussion has largely ignored the potential U.S. tax consequences that may arise for i-poker operators and U.S.-based i-poker players.

### Flow of Funds Which Raise U.S. Tax Issues

The i-poker sites are based offshore. As a result, the flow of funds to the i-poker operators will necessarily involve offshore financial transactions. Generally, U.S.-based i-poker players would deposit funds in offshore bank accounts. As a result, the U.S.-based i-poker players likely had control over an offshore bank account, potentially for several years. In order for the U.S.-based i-poker players to recover funds on deposit with the i-poker operators, it may be necessary to repatriate the funds from the offshore accounts.

The presence of the offshore accounts raises considerable U.S. federal tax issues for the i-poker player. The U.S. federal tax law issues are related to a series of laws which require U.S. persons to report certain foreign financial assets.

### U.S. Offshore Reporting and Disclosure Requirements

A series of U.S. laws impose reporting obligations with respect to both in-bound and out-bound financial transactions. Generally, the reporting obligations run the gambit of requiring persons to disclose certain currency transactions, certain offshore financial assets, and offshore bank accounts. For the i-poker player, the obligation to disclose offshore bank accounts may be implicated.

Under U.S. law, each U.S. person who has either a financial interest or signature or other authority over a financial account that exceeds $10,000 during any part of a year must file a Report of Foreign Bank and Financial Account. The report is colloquially known as an "FBAR." An FBAR is not filed with a U.S. income tax return. Rather, individuals that are required to file an FBAR must separately file the return by June 30 for any account that is subject to reporting during the immediately preceding year.

An FBAR is merely an information return. While an FBAR is an information return, the failure to file an FBAR brings with it harsh penalties. The policy rationale is all too familiar for the gaming industry: offshore bank accounts have historically been viewed as tools to launder money and evade U.S. taxation. Consequently, U.S. tax authorities have become acutely interested in offshore financial assets.

The significant penalties imposed for failing to file an FBAR range from an amount not to exceed $10,000 for a non-willful violation to willful failures that impose a civil monetary penalty in an amount not to exceed the greater of $100,000 or 50% of the account balance. A willful failure to file an FBAR can result in criminal penalties, which include monetary fines of not more than $250,000 and/or imprisonment of not more than five years.

## What Are the Options for an I-Poker Player with an Offshore Account?

At the outset, doing nothing is likely not a prudent option for an i-poker player with an offshore bank account. During the course of the i-poker operator prosecutions, the U.S. Department of Justice will likely have access to a list of all U.S. i-poker players, if it does not already have such a list. Therefore, it could merely be a matter of time before the IRS comes knocking on the doors of U.S. i-poker players looking for FBARs and reporting any previously unreported income.

The IRS has recently announced the commencement of the 2011 Offshore Voluntary Disclosure Initiative ("2011 OVDI"). To participate in the 2011 OVDI, a taxpayer must submit certain information to the IRS on or before August 31, 2011. As a side note, the push by the IRS to increase the incidence of disclosure of offshore bank accounts is not a new development. Rather, the subject has been quite popular the last few years. In 2009, the IRS implemented an offshore voluntary disclosure initiative. The IRS enforcement efforts, including the voluntary disclosure programs, directed at offshore accounts have been the subject of considerable attention in both the mainstream media and the professional tax bar.

The stated goal of the 2011 OVDI, like its predecessor initiatives, is to bring taxpayers with offshore accounts into compliance with U.S. tax laws. The primary motive with encouraging disclosure of offshore bank accounts is that the funds held in the offshore account have often not been subject to U.S. income tax. In other words, the amount initially deposited may represent pre-tax funds, or untaxed income may have been earned on the amount held in the account. It is the untaxed funds that the IRS is most keenly interested in.

The benefit of participating in the 2011 OVDI is that a taxpayer with an undisclosed offshore account can receive assurances from the federal government that he will not be subject to criminal prosecution. A highly criticized component of the recent offshore voluntary disclosure initiatives is that the IRS has taken an inflexible approach, particularly with respect to imposition of penalties. The 2011 OVDI appears to be no different: the IRS has publicly stated in the 2011 OVDI announcements that IRS revenue agents do not have any discretion to settle matters for less than what is properly due and owing. As a result, for many taxpayers participating in the 2011 OVDI program, the IRS will not differentiate from its preset penalty structure. Experience has further taught that the IRS systematically will apply the standard 25% penalty.

The standard penalty under the 2011 OVDI is a penalty equal to 25% of the highest aggregate account balance. The 25% penalty is in addition to the 20% accuracy-related penalty based on the amount of underpayment of tax and failure to file and/or failure to pay penalties. In certain limited circumstances, a 12.5% or 5% penalty may be available in lieu of the 25% penalty.[1] The 12.5% penalty is applicable when the offshore account balance is less than $75,000 for each of the years covered by the voluntary disclosure.

## Practical Considerations for the I-Poker Player

The 2011 OVDI is a tax amnesty program that may be available to i-poker players. As outlined above, to the extent that an i-poker player has unreported income attributable to an offshore financial account, the 2011 OVDI is likely available. It should be noted that individuals with undisclosed offshore bank accounts, but who reported all income, need not participate in the 2011 OVDI. Rather, "[t]he purpose for the [2011 OVDI program] is to provide a way for taxpayers who did not report taxable income in the past to come forward voluntarily and resolve their tax matters."[2] Thus, for taxpayers that have reported all their income, but simply not filed FBARs, the taxpayers are instructed to file the late FBARs with an explanation. [3]

## Conclusion

The U.S. criminal indictments of i-poker operators have garnered significant attention throughout the gaming community. The indictments have stirred discussion with respect to the continuing viability of the i-poker industry in the United States. Further, the indictments have spawned greater focus on federal and state legislative initiatives to authorize i-gaming in the U.S. The U.S. tax consequences have largely been ignored. These tax issues include not only the prospect for having unreported income, but also dealing with

the morass of potentially having control over a previously undisclosed offshore bank account.

[1] It has been our experience that the 5% penalty is available, if at all, in extremely rare circumstances.
[2] *See* IRS 2011 Offshore Voluntary Disclosure Initiative – Frequently Asked Questions and Answers, FAQ-17 (Feb. 8, 2011).
[3] *See id*.

Author's Note: In response to IRS Circular 230 requirements, any discussions of federal tax issues in this article are not intended to be used and may not be used by any person for the avoidance of any penalties under the Internal Revenue Code, or to promote, market, or recommend any transaction or subject addressed herein.

## FEDERAL INDICTMENTS SPUR I-GAMING CONFERENCES

by Robert W. Stocker II

The recent federal i-gaming indictments in New York and Maryland have been cannon fodder for recent and upcoming gaming conferences being held in the United States marketed by a variety of conference companies. While there has been much speculation about the motivations of the United States Department of Justice, the fact remains that the indictments have been consistent with the long-stated public position of the Department of Justice.

The most compelling question arising out of the indictments is quite basic: Are the prospects for the legalization of expanded internet gaming in the United States dead in the water? The answer is NO.

State governments are hungry for cash. The federal government is spending like a drunken sailor, amassing deficits that threaten the economic well-being of the country. The political class has great difficulty initiating and enforcing serious spending cutbacks. The search is on for sources of revenue that do not involve raising the taxes of John Q. Citizen. At the federal levels and in most states, there is insufficient support for raising business taxes for fear of triggering a second recession dip.

The net result? Several states are already dealing with legislative proposals to expand land-based commercial casinos. Illinois is one of the leaders. Illinois has also taken a leading position in expanding its lottery into internet operations. The District of Columbia has adopted internet gaming legislation and is working on implementing that legislation. Nevada has signed into law new intrastate internet gaming legislation, albeit subject to careful coordination with the United States Department of Justice. Intrastate internet gaming legislation is far from dead in New Jersey, California, Iowa, and Florida. At the federal level, internet gaming legislation was introduced again.

The real question is what government (state or federal) will tear down the wall? The odds favor the states. Congress is not focused on legalizing internet gaming – it is not on the top 20 list of issues being seriously debated in Congress. In addition, the presidential election is in November 2012, and the presidential silly season has already begun. Both parties are focused on maintaining control of the respective chamber controlled now and getting control of the other chamber. Making internet gaming centerpiece legislation is simply not in the cards.

The state legislatures are a completely different environment. Most states have state constitutions that require a balanced budget. While legalization of intrastate internet gaming will not instantly bring new revenues to state coffers in 2011, it can provide significant revenues in 2012. Moreover, in states that already have commercial and/or Indian casinos, the bias against gaming has already been shattered. Therefore, look for continued action first from the states on the intrastate internet gaming front.

Operators who have long considered the United States market to be a prime opportunity for internet gaming are making a huge mistake if they turn their backs on the United States market. Now is the time to increase the focus on the passage of internet gaming legislation – at the state level. Once several states adopt intrastate internet gaming (or Indian country embraces internet gaming), it will be only a matter of time before there will be federal legislation, somewhat akin to what occurred once casino gaming received the go-ahead in Indian country through federal court cases (which resulted in the enactment of the Indian Gaming Regulatory Act after the horse was already out of the barn and galloping across Indian country).

## DETROIT CASINOS' MAY REVENUES INCREASE FROM SAME MONTH LAST YEAR: MICHIGAN GAMING CONTROL BOARD RELEASES MAY 2011 REVENUE DATA

by Ryan M. Shannon*

The Michigan Gaming Control Board ("MGCB") released the revenue and wagering tax data for May 2011 for the three Detroit, Michigan, commercial casinos. The three Detroit commercial casinos posted a collective 2.7% increase in gaming revenues compared to the same month in 2010. Aggregate gross gaming revenue for the Detroit commercial casinos decreased, however, by approximately 4.2% compared to April 2011 revenue figures, continuing the trend of a similar drop in revenues between April and May in prior years.

MGM Grand Detroit posted positive gaming revenue results for May 2011 as compared to the same month in 2010, with gaming revenue increasing by more than 4.8%. MGM Grand Detroit continued to maintain the largest market share among the three Detroit commercial casinos, and had total gaming revenue in May 2011 of slightly over $51 million. MotorCity Casino had monthly gaming revenue approaching $39 million, and posted a 1.1% improvement in May 2011 over its May 2010 revenues. Greektown Casino also posted a positive gaming revenue result in May 2011 compared to May 2010, with a 1.2% increase in total revenues. Greektown had gaming revenue of approximately $30 million for May 2011.

The revenue data released by the MGCB also includes the total wagering tax payments made by the casinos to the State of Michigan. The gaming revenue and wagering tax payments for MGM Grand Detroit, MotorCity Casino, and Greektown Casino for May 2011 were:

| Casino | Gaming Revenue | State Wagering Tax Payments |
|---|---|---|
| MGM Grand Detroit | $51,196,720.20 | $4,146,934.34 |
| MotorCity Casino | $38,800,817.32 | $3,142,866.20 |
| Greektown Casino | $30,042,825.97 | $2,433,468.90 |
| Totals | $120,040,363.49 | $9,723,269.44 |

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