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Re: *Daily Fantasy Sports and Wagering
Excise Tax Evasion, inter alia*

Dear Friends at the Internal Revenue Service,

The following is my opinion, based on years of experience as a federal prosecutor and recent legal research. I trust you will find it sound and warranting action on your part that will result in recovery of many millions of evaded wagering excise tax dollars and, most important, improved knowledge of and compliance with tax laws.

The Unlawful Internet Gambling Enforcement Act of 2006 ("UIGEA"), 31 USC §§5361-5367 (*see also* regulations at 31 CFR Part 132 and 12 CFR Part 233), prohibits gambling businesses from knowingly accepting payments in connection with the participation of another person in a bet or wager that involves the use of the Internet and that is unlawful under any federal or state law. UIGEA also required certain federal agencies to adopt regulations requiring certain participants in payment systems that could be used for unlawful Internet gambling to have policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit the processing of restricted (i.e., unlawful) transactions.

The *Daily Fantasy Sports* (“DFS”) industry (and the many otherwise seemingly-legitimate business/sports leagues/teams partnering with the DFS industry) frequently cite to the UIGEA statute as supporting their claim that these DFS businesses do not involve gambling or, if it seems like they do, they have an exemption due to a fantasy sports “carve-out” in UIGEA. That statute, passed in 2006, does indeed include broad language that “any” fantasy sports game participation (which participation meets a number of other criteria set out in the statute) does not involve bets or wagering and, so, seemingly could not be gambling, by definition—and this may be so, argue the DFS advocates, even though “daily” fantasy sports did not exist in 2006. After all, they contend, “any” means any and all, right? Upon a merely-surface reading, then, DFS businesses would seem to fall within the carve-out.

But surface readings are too often superficial, and those prone to make them tend to see only the result they want to see, especially when the prospect of making huge profits clouds their judgment. Let’s look a bit deeper and with less concern for personal lucre:

31 U.S.C. §5362 expressly sets out that its definitions are applicable for the UIGEA statute **only**, given that it provides:

“In this subchapter (emphasis supplied):

(1) **Bet or wager.**— The term “bet or wager”—

(E) does not include—(...)

(ix) participation in any fantasy or simulation sports game or educational game or contest in which (if the game or contest involves a team or teams) no fantasy or simulation sports team is based on the current membership of an actual team that is a member of an amateur or professional sports organization (as those terms are defined in section [3701](#) of title [28](#)) and that meets the following conditions:

(I) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants.

(II) All winning outcomes reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individuals (athletes in the case of sports events) in multiple real-world sporting or other events.

(III) No winning outcome is based—

(aa) on the score, point-spread, or any performance or performances of any single real-world team or any combination of such teams; or

(bb) solely on any single performance of an individual athlete in any single real-world sporting or other event.”

The plain words of this definitional statute, then, *are limited to the subchapter in which it appears*. Consequently, conduct which is defined as not betting or wagering for UIGEA purposes can be betting or wagering for other purposes. Does this make sense? Yes, once one considers what the purpose of UIGEA is. After setting out a number of findings, at §5361(a)(4), Congress stated UIGEA’s purpose is to aid in “...enforcing gambling prohibitions or regulations

on the Internet, especially where such gambling crosses State or national borders[,]” and doing so without “altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States.” 31 USC §5361(b).

Thus, getting to my point: the several DFS businesses (FanDuel, DraftKings, etc.) operating in the United States (with more coming all the time) are clearly engaged in betting or wagering for purposes of the wagering excise tax. Relevant wagering excise tax Internal Revenue Code sections (IRC §§4401, 4404, 4411, and 4421 (the latter of which defines wagering)) and relevant regulations (Reg. 44.4401, *et seq.*) are unaffected by the UIGEA limited-purpose definitions. Indeed, in most cases, these usually-Internet-based DFS enterprises plainly are conducting their gambling activities in contravention of federal and state laws, as I believe you will find they are unlicensed to operate gambling enterprises in any states (indeed, they likely haven’t even sought gambling licensing, since the DFS operators contend they are not engaged in gambling—but, in this, they have plainly over-extended UIGEA’s definition which, by its terms, is limited to that subchapter of Title 31). Their continued evasion of this wagering excise tax obligation robs the public fisc of needed revenue. Industry estimates extend to billions of dollars in revenue garnered by DFS enterprises in the short term. Even using the quite modest wagering excise tax rates, effective enforcement of this portion of the Internal Revenue Code will produce many millions of dollars our nation needs.

As you may recall, I was the career federal prosecutor (AUSA—EDMO) who, with an assist from others (mainly a DOJ OCRS attorney and, especially, a superb then-Special Agent, Joe Ludewig, of IRS-CI) in 2006, was lead counsel in utilizing wagering excise tax evasion charges, together with RICO, Wire Act, and related charges to help halt significant illegal online sports bookmaking operations, including the Gary Kaplan-led BetonSports enterprise, then the world’s largest online sportsbook. (Colleagues helped resolve that case after I retired in 2008.) Kaplan recently lost his 8th Circuit appeal of an adverse-to-him U.S. Tax Court ruling, and the approximately \$37 million in back taxes and penalties he must now pay can be added to the nearly \$50 million the government gained via criminal forfeiture from him and his co-defendant sister. I point this out as proof that **these cases clearly pay for themselves many times over**. (Other multi-million dollar-generating online gambling criminal cases I have handled, or helped advance via information-sharing and/or training, include the Paradise Casino prosecution (E.D. Mo.), the Gold Medal Sports prosecution (W.D.Wisc.), and the “Black Friday” online poker prosecutions (S.D.N.Y.). These cases have deterrent value and generate far more revenue for the United States than their resource costs.) An additional feature of wagering excise tax prosecutions, helping to speed the process after appropriate internal IRS counsel review, is that such cases do not need DOJ Tax Division review and approval (at least they didn’t when I was an AUSA; if that has changed, I am unaware of it).

In today’s marketing efforts of DFS enterprises, I see the same kind of overt misrepresentations and bogus claims of legality being made (by DFS operators) as I saw in the late ‘90s and early ‘00s, when online gambling first made an effort at operating throughout the United States without legal authorization. When enacted, UIGEA’s intent plainly did not authorize the then non-existent *Daily Fantasy Sports* industry, nor was the statute designed allow that industry to escape excise tax obligations. Further, these DFS operations and practices appear to repeatedly violate the Professional and Amateur Sports Protection Act (PASPA), the federal Wire Act and

Gambling Act, and numerous state statutes. Much dithering about who will enforce which statutes against these nation-wide violators can be truncated by IRS taking its rightful place as a leader against tax-law-violative organized financial crime. Even gamblers recognize DFS is gambling: see, for example, <http://www.uspoker.com/blog/yes-fantasy-sports-betting-is-gambling/12113/> and <http://www.legalsportsreport.com/2677/is-daily-fantasy-sports-gambling/>.

I. What is “Daily Fantasy Sports?”

Season-long fantasy sports started as a hobby and a form of community. It was a social activity, not a commercial one. The trophy mattered more than the money. Now, however, through the introduction of “*Daily Fantasy Sports*” (DFS), fantasy sports has been turned into a fleecing operation, a commercial pursuit plainly incorporating the three elements of gambling: consideration, chance, and prize.

In season-long games, participants may exercise a great deal of skill in operating a team. They have to figure out who to draft, play, and trade while monitoring and analyzing statistics and making adjustments throughout the season--doing all those things in hopes of having a successful season. Participants typically accumulate points based on the statistical accomplishments of the athletes they have selected to their teams through a draft. As originally conceived, these games were contested between friends and took place over the course of a sport’s regular season.

Internet gambling operators like FanDuel and DraftKings altered both the traditional structure and the business model: Daily fantasy sports contests restart constantly and typically are played against strangers. Contests don’t begin with a draft. Contestants are given a “salary cap” with which to choose real players, whose “price” is set commensurate with their perceived ability. For example, it might cost \$10,000 in “salary cap” money for Tom Brady and \$6,000 for a lesser-regarded quarterback like Matt Ryan.

Rather than simply hosting leagues for users, daily fantasy sports gambling operators serve as an exchange, and they profit by keeping a cut of the money wagered, commonly referred to in gambling parlance as “the rake,” “vig” or “vigorish,” or “juice.” (Some DFS enterprises have developed variant games, but the greatest revenue producer falls within the above description, upon information and belief.)

II. “Daily Fantasy Sports” is Internet Sports Gambling

Make no mistake, “daily fantasy sports” is internet sports gambling. Both internet gambling *and* commercial sports gambling are *illegal* in most every state, absent a license and statutory authorization.

Many of America’s casino operators and gambling regulators openly describe DFS as “gambling.” MGM Casinos Chairman Jim Murren recently said those who argue that daily fantasy games are not gambling are “absolutely, utterly wrong.” He said “I don’t know how to run a football team, but I do know how to run a casino, and this is gambling.”ⁱ

The CEO of major sports book operator William Hill U.S., Joe Asher, echoed Murren's declaration. "You put up of something of value, cash, to win something of value, cash. It's the classic definition of gambling...any suggestion that (fantasy sports) is not gambling is the biggest bunch of baloney I've ever seen."ⁱⁱ

DFS *does meet all* of the requirements of the fundamental definition of gambling. It has **consideration** (the player wagers money), **prize** (the player wins cash prizes), and **chance** (there must be at least enough variance that an unskilled or lesser skilled bettor can win the prize, at least in the short run.)

Sports gambling operators deceptively claim that DFS is "a game of skill," but the presence of skill is irrelevant. Even if you were to argue that a "skilled" DFS player is not gambling, then it would also be true that a lesser or unskilled player must be gambling. The very existence of skilled DFS players – playing with an edge and for a profit – **depends on the presence of lesser skilled players** willing to gamble at a disadvantage against them. You can't have a skilled DFS player without a compensating gambler.

"[D]aily fantasy games have a fundamentally different relationship to chance than season-long fantasy games. On a given day an injury, a hailstorm, or a ball bouncing strangely could affect a result. In this regard, playing daily fantasy seems very similar to placing a bet with a bookmaker, said Ryan Rodenberg, an assistant professor of sports law at Florida State University." J. Brustein, *Fantasy Sports and Gambling: Line is Blurred*, New York Times, Mar. 12, 2013, at B9.

III. The ultimate goal of DFS gambling operators is to be a bridge to full-scale, widespread sports gambling.

"Legalized sports gambling is the endgame," said Laurence DeGaris, a University of Indianapolis sports marketing professor who has been a sponsorship consultant for the National Football League and the National Hockey League. "One-day fantasy delivers a similar fan experience to gambling, so I expect the current database of customers would provide a good foundation for sports gamblers."ⁱⁱⁱ

Marc Edelman, an associate professor of law at Baruch College in New York who consults on legal issues for online fantasy sports companies, affirmed the real intent behind these DFS gambling operators: "**The online platform for daily fantasy sports contests, for the most part, already looks incredibly similar to sports books in casinos. And they were not designed that way by accident.**"^{iv}

This explains why when Draft Kings recently expanded into the United Kingdom, one of the minority of countries in the world that allows internet gambling, it was forced to get a license to operate by the UK Gambling Commission for running "gambling software" and "pool betting." ^v The gambling license "entitles the licensee to manufacture, supply, install and adapt gambling software for electronic devices or websites" and "entitles the licensee to provide facilities for pool betting by remote communication."^{vi} (An August 20, 2015

screenshot taken of Draft Kings license to run a commercial gambling operation in the UK can be found at the end of this letter.)

IV. “Daily Fantasy Sports” Does Not Benefit the People

FanDuel, DraftKings and similar commercial sports gambling operators (*e.g.*, Kountermove, BetAmerica, HotRoster, DailyMVP, FanNation, ScoreStreak, Tradesports, Victiv (the latter recently acquired by the Amaya gambling conglomerate)) are not the result of a grassroots citizens movement demanding internet gambling. Rather, they seem to be the end result of powerful financial interests seeking to evade state and federal laws at the expense of everyday people.

“DFS” damages citizens financially. It’s not a question about shaving points. It’s about shaving big money from the wallets of low and middle income people. The only way the daily fantasy sports model works is by attracting poor players - the fish - to feed the good ones - the sharks.

“Sharks” are the players whose successes lure in the masses, whose less-sophisticated wagers generate a substantial amount of the profits or “rake” for these sites. These “sharks” are experts, designing and using sophisticated algorithms to take other people's money. Sometimes, they can make a reasonable return from their educated bets.

“Fish” are citizens who tend to be new sign-ups with limited experience and who lose their money. Finding new fish to feed to the sharks is the most important requirement for this scheme to succeed over the next few years, and DFS operators’ marketing deals with pro sports teams and leagues are a key to making it happen. In other words, the real driver of growth and profit lies in finding as many new fish as possible. Without these fish, the model falls apart.

DFS gambling operators claim they are simply about providing people a better “fan experience.” This June 2014 excerpt from a *Wall Street Journal* story, however, reveals how DFS has little to do with being a “fan:”^{vii}

“He (Cory Albertson) may be the most consistently profitable fantasy sports enthusiast in the country. And the reason is that to him, fantasy sports isn't really about sports. It's about data. He doesn't trust his eyes to tell him who the best players are; he only trusts the numbers, which tell him who is overvalued and who is undervalued. Albertson's strategy is almost literally a formula, and it bears little resemblance to casual fandom. "It's all about having logical inputs that lead to logical outputs," he says.”

The result of all this evening's research and effort is that Albertson's algorithm determined the optimal lineup for a fantasy basketball team. More precisely, on Albertson's command, it produced hundreds of lineups that collectively represent a diverse portfolio that will, he hopes, generate thousands of dollars in profits by the end of the night's games, in about six hours.

He says the future of the industry is based on attracting casual fans. "If this is going to get huge, we need the guys who are going to buy in for \$20. They do it for fun," Wiggins says. But if that

*happens, number-crunching sharks like Albertson will be lying in wait. **If casual players embrace daily fantasy in bigger numbers, Albertson says, "then we'll really be a printing press."***^{viii} (emphasis supplied)

Anyone who has studied commercial gambling will recognize that this is the classic formula for commercial gambling's profitability.

V. Sports Gambling Operators Are Targeting Youth

No demographic is a bigger target for internet sports gambling operators like FanDuel and Draft Kings than America's youth. This should concern everyone because it is well-established that the younger children start gambling, the more likely it is they will become habitual, pathological, and problem gamblers.^{ix} According to data from the Fantasy Sports Trade Association, almost 10 million of the estimated 51.6 million fantasy sports players are under 18.^x One of the most recent companies to launch its own sports gambling operation, Yahoo, has thousands of minors playing free fantasy sports right now. The obvious business model is to convert these "for-free" players into "real-money" gamblers. No doubt, many of these kids will be lured into real-money DFS gambling games at Yahoo and other gambling operators.

Internet gambling is especially addictive for youth who have grown up playing video games. By deceiving the nation's youth into online gambling, these sports gambling operators are setting up an entire generation of young people to become problem gamblers by making exploitive forms of gambling omnipresent in everyday life, *whether in their own homes or on the smartphones they carry with them everywhere*. When you combine that ubiquitous presence and availability together with the intense passion kids have for their favorite athletes and sports, and then blend in sophisticated targeted marketing and player data tracking and tendency exploitation, DFS presents a dangerous, predatory mix---one *not at all in the public interest*. Federal excise tax evasion simply counts as one ingredient in this mix—but one you can do something about.

VI. "Daily Fantasy Sports" Violates Federal Law

Sports gambling operators running DFS games appear to be in direct conflict with the Professional and Amateur Sports Protection Act of 1992 ("PASPA"). While PASPA is commonly understood to prohibit state-regulated sports betting on the outcomes of professional and amateur sporting events, it also contains language that readily applies to daily fantasy sports. Section 3702 of PASPA states:

It shall be unlawful for --

- (1) a governmental entity to sponsor, operate, advertise, promote, license, or authorize by law or compact, or
- (2) a person to sponsor, operate, advertise, or promote, pursuant to the law or compact of a governmental entity, a lottery, sweepstakes, or other betting, gambling,

or wagering scheme based, directly or indirectly (through the use of geographic reference or otherwise) on one or more competitive games in which amateur or professional athletes participate, or are intended to participate, **or on one or more performances of such athletes in such games.** (emphasis supplied)

Daily Fantasy Sports *are inherently tied* to the individual performances of athletes in a game rather than on the final score of the game itself. Any state legislation which attempts to legalize fantasy sports would be doing so in direct violation of PASPA's express prohibition against state sponsorship of sports wagering schemes that are based on the individual performance of athletes in an amateur or professional sporting event. Likewise, "persons" that promote or advertise fantasy sports contests to United States residents are also violating PASPA. *See also*, 18 U.S.C. §2.

Furthermore, DFS operators appear to regularly violate the federal Interstate Wire Act of 1964 ("Wire Act"), 18 U.S.C. §1084, and the Illegal Gambling Business Act of 1970 ("Gambling Act"), 18 U.S.C. §1955. As noted above, DFS operators often defiantly claim that their gambling is shielded by a "carve-out" in the Unlawful Internet Gambling Enforcement Act ("UIGEA"), at 31 U.S.C. §5362(1)(E)(i)-(ix)(2006), but they fail to note that the fantasy sports carve-out was necessarily intended to protect only traditional season-long participants (since the daily game industry did not exist when UIGEA was enacted), and the carve-out only applies to those games where a minimum threshold of skill-to-chance exists; however, as the Kansas Racing & Gaming Commission found, necessarily chance predominates in all fantasy sports contests. *See* <http://www.krgc.ks.gov/index.php/component/content/article/2-uncategorised/113-fantasysportsillegal>. Likewise, Florida's Attorney General sensibly observed that "[w]hile the skill of the individual contestant picking the fantasy team is involved, prizes are paid to the contestants based upon the performance of the individual [athletes]...in actual games" rather than upon the direct performance of the fantasy sports participants. *See* Fla. Op. Att'y Gen. 91 3 (1991), available at 1991 WL 528146.

VII. What Must Be Done

For all of these reasons, I implore you to take appropriate strong, immediate action against these illegal sports gambling operators:

- Investigate and prosecute offenders.
- Collect evaded wagering excise taxes, with interest and penalties
- Forfeit illegally-generated proceeds.
- Work with federal and state counsel to enjoin the operation of illegal DFS operations.

Some have said the present federal administration is not doing its job in this regard, but I have every confidence in your abilities to use statutes and common law remedies as tools to

abate the on-going lawlessness, the deceptive and unfair marketing, the environmental nuisance, and the growing public health risks stemming from the continuing, corrupting, exploitive conduct of DFS operators. Protect the excise tax system Congress has enacted, as well as protecting citizens and families from continued exploitation driven by DFS operators' relentless and deceptive marketing. (Additionally, I would expect that your excise tax-oriented-investigations will also uncover significant income tax evasive-activity, as we found in the BetonSports case.)

I urge you to rapidly begin the criminal and civil investigations that, in my opinion, the behavior of the DFS industry invites. I invite you to contact me for any additional information about this very important issue.

Sincerely,

Michael K. Fagan

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Account details

Reference	A2479				
Licensee name	Drathtings Ltd				
Principal address	125 Summer Street 5th Floor DOCTON MD 21113				
Licensed activities					
Status: Active ?					
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Pod Betting	?				
Sanctions					
Trading names					
Domain names					
www.drathtings.com					

Source: Screenshot taken of UK Gambling Commission website, 8/20/2015

ENDNOTES

- ⁱ “Gambling or a Game of Skill: Debate Swirls Over Fantasy Sports,” *Las Vegas Review Journal*, July, 11, 2015, <http://www.reviewjournal.com/business/casinos-gaming/gambling-or-game-skill-debate-swirls-over-fantasy-sports>
- ⁱⁱ *Ibid.*
- ⁱⁱⁱ Daily Fantasy Sites Seen Positioned for Jump to Sports Gambling,” *Bloomberg Business News*, February 24, 2015 <http://www.bloomberg.com/news/articles/2015-02-24/daily-fantasy-sites-seen-positioned-for-jump-to-sports-gambling>
- ^{iv} “Daily Fantasy Sites Seen Positioned for Jump to Sports Gambling,” *Bloomberg Business News*, February 24, 2015 <http://www.bloomberg.com/news/articles/2015-02-24/daily-fantasy-sites-seen-positioned-for-jump-to-sports-gambling>
- ^v DraftKings heading to UK, hires gambling-industry veteran to lead expansion,” *The Boston Globe*, August 17, 2015 <http://www.betaboston.com/news/2015/08/17/draftkings-heading-to-uk-hires-gambling-industry-veteran-to-lead-expansion/>
- ^{vi} Text taken from Draft Kings gambling license #42475, issued by UK Gambling Commission, <https://secure.gamblingcommission.gov.uk/gccustomweb/PublicRegister/PRAccountDetails.aspx?accountNo=42475>
- ^{vii} “A Fantasy Sports Wizard's Winning Formula,” *The Wall Street Journal*, June 4, 2014 <http://online.wsj.com/articles/a-fantasy-sports-wizards-winning-formula-wsj-money-june-2014-1401893587>
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