

MEMORANDUM

TO: Representative Janet Ancel, Chair, House Committee on Ways and Means
Senator Ann Cummings, Chair, Senate Committee on Finance

FROM: Susanne R. Young, Secretary, Agency of Administration 
Kaj Samsom, Commissioner, Department of Taxes

DATE: December 15, 2017

RE: Fantasy Sports Contests Proposal Pursuant to Section 4 of Act 70 (2017)

This proposal is submitted in accordance with Section 4 of Act 70 (2017). Act 70 allows fantasy sports contests to be operated legally in Vermont and creates a regulatory structure for fantasy sports operators who do business in Vermont.¹ Section 4 reads:

Sec. 4. FANTASY SPORTS CONTESTS; PROPOSALS

On or before December 15, 2017, the Secretary of Administration shall submit to the House Committee on Ways and Means and the Senate Committee on Finance a proposal for fantasy sports contests concerning:

- (1) any amendments to the registration requirements or registration fee imposed in Sec. 5 of this act; and*
- (2) an appropriate percentage tax on an appropriate measure of revenue.*

Recommendations

The Secretary of Administration, after consultation with the Secretary of State, recommends maintaining the registration requirements and \$5,000 fee established in Section 5 of Act 70 (adding 9 V.S.A. § 4189). These are essentially the same registration requirements imposed on other business entities doing business in Vermont. The current annual fee covers the Secretary of State's administrative costs related to registration. The Secretary further recommends consulting with the Office of the Attorney General to determine whether additional statutory authority is required to bill back its costs related to the enforcement provisions of the fantasy sports contests chapter.²

¹ 9 V.S.A. ch. 116.

² *Id.*

The Secretary does not recommend that a new tax structure be created for fantasy sports operators. Operators are currently subject to Vermont's income tax laws like any other business in Vermont, and may have a tax liability according to their individual circumstances. Individuals who participate in fantasy sports contests may also be liable to pay personal income tax on fantasy sports contest earnings under current Vermont law.

Registration Requirements and Fee Considerations

Act 70 requires fantasy sports operators to register annually on or before October 15 with the Secretary of State, and to pay an annual \$5,000 fee.³ The general registration requirements are the same as those imposed on any entity doing business in Vermont under titles 11-11C,⁴ and as stringent as those imposed on any other entity required to register with the Secretary of State. The current \$5,000 annual registration fee is adequate to cover the Secretary of State's costs of administration, maintenance, and other expenses due to performing the regulatory function of registering fantasy sports operators. The current fee meets the Vermont statutory requirement that fees be "reasonably related to the cost of providing the associated service or product or performing the regulatory function." "Costs" for this purpose are to be "narrowly construed, but may include reasonable and directly related costs of administration, maintenance, and other expenses due to providing the service or product or performing the regulatory function."⁵

Some states have created a fee exemption, or a tiered, discounted, or percentage-of-revenue-based fee structure for smaller operators to help level the playing field with larger operators so that small operators pay a smaller portion of their revenues than they would under a flat fee structure. The drawback to this more complex fee structure is the increased administrative burden, and related costs, inherent in its implementation and ongoing administration. The fee for larger operators would need to be above \$5,000 to cover the additional costs if the fees for smaller operators were lowered under a tiered structure. To avoid added complexity and increased costs for both the State and operators, it is recommended that the registration fee be maintained at its current level.

Vermont's fantasy sports registration fee is comparable to other states that regulate fantasy sports operators, except that states that charge a \$5,000 fee also impose a tax on operators. In states that impose only a fee, the fee is typically a \$50,000 *one-time* fee. Delaware and Missouri are exceptions, and charge both taxes and high annual fees. Delaware charges a \$50,000 annual fee. Missouri charges an annual application fee that is the lower of \$10,000 or 10% of net revenue from the previous calendar year. On the other end of the spectrum, states like Maine and Colorado only charge fees for operators who have over \$100,000 in gross revenues (Maine) or more than 7,500 players in the state (Colorado). Please refer to the chart in the Appendix that compares the tax and fee structures imposed on fantasy sports operators in other states.

³ 9 V.S.A. § 4189.

⁴ *Id.*

⁵ 32 V.S.A. § 603(2); *see also*: 32 V.S.A. § 605(d)(2).

Act 70 requires fantasy sports operators to comply with several business practices intended to provide protections to consumers who choose to participate in fantasy sport contests, and are enforceable by the Office of the Attorney General. The Attorney General may also adopt rules to implement the fantasy sports contests chapter, and may conduct civil investigations, enter into assurances of discontinuance, and bring civil actions.⁶ At this early stage of operations in Vermont, the Secretary recommends consulting with the Office of the Attorney General to amend its authority as necessary to provide bill back authority or some other mechanism to cover the cost of any investigations or enforcement activities taken under chapter 116, in a manner that would not limit the authority to actions filed in court. Initially, this would ensure that the State's costs are covered by the operator investigated and offset the burdens of a flat fee on smaller operators. Similar "bill back" authority exists for other departments, such as the Department of Public Service⁷ and the Department of Financial Regulation.⁸

Tax Considerations

Act 70 did not impose any additional taxes on fantasy sports operators in Vermont. The Secretary does not recommend imposing any taxes in addition to those applicable to both fantasy sports operators and players under current Vermont law.⁹ Vermont's business income tax laws will apply to fantasy sports operators in the same way that they apply to other business entities. Regardless of the fantasy sports operator's legal structure (e.g., as a C corporation, S corporation, limited liability company, or partnership), it will likely be required to file and pay at least the minimum tax.¹⁰ Additionally, the earnings made by individual players will be taxed under the same personal income tax sections applicable to any other individual with Vermont taxable income. The consumer protection sections in the Act reinforce this by requiring fantasy sports operators to notify players that winnings of a certain amount may be subject to income taxation.¹¹

Imposing a tax with the limited information currently available about annual revenue likely to be generated in Vermont from fantasy sports operators raises many concerns regarding complexity, administrative costs, regressivity, and market impact. The Vermont Department of Taxes estimates that implementing and administering a new tax on fantasy sports operators would cost a minimum of \$80,000 per year for the first several years. These costs arise from human resources and information system investments. Said another way, the minimum annual revenue that the tax would have to generate to pay for itself is \$80,000. In order to generate \$80,000, the tax rate on operators would have to be at least 11% of annual net revenues.¹²

⁶ 9 V.S.A. § 4190(b).

⁷ See, e.g., 30 V.S.A. §§ 20-21.

⁸ See, e.g., 8 V.S.A. § 3563.

⁹ 32 V.S.A. ch. 151.

¹⁰ 32 V.S.A. §§ 5811(15)(B), 5832, 5862(a), 5915, 5921.

¹¹ 9 V.S.A. § 4186(a)(8).

¹² See Vermont Legislative Joint Fiscal Office, *Fiscal Note* (March 23, 2017), available online <<http://legislature.vermont.gov/assets/Documents/2018/WorkGroups/Senate%20Finance/Bills/S.136/S.136--Sara%20Teachout~Fiscal%20Note~3-24-2017.pdf>>. This 11% tax rate was based on the tax rate proposed at the time in Senate bill S.136 (the bill that became Act 70).

Other states have structured their fantasy sports tax as a percentage between 6% and 15.5% of operators' revenues, occasionally tiered depending on the amount of revenue earned. The base taxed in other states varies from net revenues, adjusted revenues, net-adjusted revenues, or gross revenues from contests within the State. A tax based on net revenue rather than gross revenue is preferential for operators because net revenue represents actual profit. A tax based on gross revenues does not take into account contest winnings paid out to players and reduces the profit operators actually receive.

Another concern is the impact of a tax on an operator's decision to do business in Vermont. The fantasy sports market seems to have a few large operators, and many small operators. Legislative testimony from industry representatives in Vermont and other states has highlighted that a tax and a fee are more easily absorbed by large operators, which could give them a competitive edge, and potentially stifle competition from smaller operators. Some states have mitigated the regressive impact of taxes on smaller operators by exempting operators making below a certain threshold of revenue, such as Maine's model that sets the threshold for tax liability at \$100,000 in annual gross revenue. While this may help make a new tax more equitable, this approach again increases complexity for taxpayers, which in turn increases compliance costs. A complex tax structure could have a negative impact on a new market.

Conclusion

The registration requirements and annual \$5,000 fee created by Act 70 are sufficient to cover the costs of registering fantasy sports operators. It may be useful to create, as necessary, bill back authority or another mechanism for the Office of the Attorney General to cover its enforcement expenses. There is no need to impose an additional tax, because operators and individual players will be subject to Vermont income tax laws. Moreover, the cost of administering the tax during the first few years would absorb most, if not all, revenues generated according to current information and estimates. As a new industry with potential for growth, it would be worthwhile to revisit the question of whether the cost of regulating the industry is met through the current fees, revenues, and enforcement mechanisms included in Act 70 after the industry has operated in Vermont over a period of years allowing for better information and data regarding Vermont's fantasy sports contest market.

OTHER STATES' TAXES AND FEES ON FANTASY SPORTS

18 states have taken legislative action to legalize daily fantasy sports.¹³ The majority of states regulate operators in some way, with the primary goal being consumer protection. 13 states impose a tax, a fee, or both, which are compared in the chart below.

State & Bill	Tax, Fee, or Both	Tax Rate	Tax Base	Flat Fee	Revenue	Regulatory Body
Arkansas (Act 1075 of 2017)	Tax	8%	Gross paid fantasy sports game revenues		Unknown	Department of Finance and Administration
Colorado (HB 1404 of 2016)	Fee			All operators must register, but only fantasy contest operators with more than 7,500 fantasy contest participants in Colorado are required to pay a licensing fee. Fee to be determined by Division of Professions and Occupations (not set in statute or rule. C.R.S. 12-15.5.105; C.C.R. 751-1.).	Projections FY16-17: \$125,790; FY17-18: \$210,790	Division of Professions and Occupations, Department of Regulatory Agencies
Connecticut (SB-1502 of 2017)	Both tax & fee	10.5%	Gross receipts of fantasy contest operator	Initial registration fee: \$15,000 Annual registration renewal fee: \$15,000	Projection FY19 \$500,000	Commissioner of Consumer Protection

¹³ Ohio's legislature passed HB 132 of 2017, but at the time of writing this report, the bill had not yet been signed by the Governor. The following 18 states have enacted legislation legalizing and regulating fantasy sports: Arkansas, Colorado, Connecticut, Delaware, Indiana, Kansas, Maine, Maryland, Massachusetts, Mississippi, Missouri, New Hampshire, New Jersey, New York, Pennsylvania, Tennessee, Vermont, and Virginia. Out of those states, four did not include fees or taxes: Kansas, Maryland, Massachusetts and New Hampshire. Three other states have not taken legislative action because fantasy sports were determined to already be legal under state law: Nevada (interactive gaming license required for \$500,000 initial application fee, \$250,000 annual renewal fee), Rhode Island, and West Virginia. Although the Massachusetts' Attorney General also found that fantasy sports were already legal under state law, legislation was nonetheless enacted to explicitly legalize and regulate them. Maryland's Attorney General has questioned whether the state's 2012 gambling statute applied to daily fantasy sports, although no clarifying legislation has been enacted.

State & Bill	Tax, Fee, or Both	Tax Rate	Tax Base	Flat Fee	Revenue	Regulatory Body
				Fees will be reduced to as not exceed 10% of operator's gross receipts for registration period.		
Delaware (H.B. 249 of 2017)	Both tax & fee	15.5%	Net-adjusted revenues	\$50,000 annual licensing fee	Projections \$100,000 annually, based only on fees (2 operators)	Commission to be designated by Governor (may be current agency or dept) within 30 days of signing.
Indiana (Act 339 of 2016)	Fee			<ol style="list-style-type: none"> \$50,000 one-time licensing fee that may be increased up to \$75,000 if division needs to cover operation costs \$5,000 annual renewal fee 	Projections <ol style="list-style-type: none"> Initial license fee in FY2017: \$250,000 \$3.75M Renewal fee starting FY2018: \$25,000-\$250,000 	Indiana Gaming Commission, Paid Fantasy Sports Division
Maine (SP 449, LD 1320 of 2017)	Both tax & fee	10%	Gross fantasy contest revenues; only applies to operators with over \$100,000 in revenue	\$2,500 initial and annual renewal licensing fee only for operators with over \$100,000 in revenue during 12 months preceding application.	\$110,000 annually	Department of Public Safety
Mississippi (H.B. 967 of 2017)	Both tax & fee	8%	Net Mississippi revenue Tax is called a fee	\$5,000 license application fee	No projections conducted by Miss. legislature	Mississippi Gaming Commission

State & Bill	Tax, Fee, or Both	Tax Rate	Tax Base	Flat Fee	Revenue	Regulatory Body
			for "privilege of conducting fantasy sports contests in Mississippi"			
Missouri (H.B. 1941 of 2016)	Both tax & fee	11.5%	Net revenue from previous calendar year. Tax is called "annual operation fee"	<ol style="list-style-type: none"> Annual application fee that is lower of: \$10,000 or 10% of net revenue from previous calendar year Investigation fee no more than \$50,000 	Projections \$500,000-\$750,000	Missouri Gaming Commission
New Jersey (A-3532 of 2017)	Tax	10.5%	Fantasy sports gross revenue		Tax (projected): \$6.6 million	Dept. of Law & Public Safety, Div. Consumer Affairs
New York (S.8153/A.10736 of 2016)	Tax	15% + 0.5%	15% on interactive fantasy sports gross revenue generated in state 0.5% capped at \$50,000		\$4,000,000	NY State Gaming Commission
Pennsylvania (Act 42 of 2017)	Both tax & fees	15%	Monthly fantasy contest adjusted revenues (from previous month)	\$50,000 application fee for 5-year license <ul style="list-style-type: none"> nonrefundable application fee cannot exceed amount necessary to reimburse board for all costs incurred in application process. 	Projections First year: \$250,000 application fees (\$50,000 initial application fee) Annual tax revenues:	PA Gaming Control Board

State & Bill	Tax, Fee, or Both	Tax Rate	Tax Base	Flat Fee	Revenue	Regulatory Body
				\$10,000 license renewal fee	\$2,100,000	
Tennessee (S.B. 2109, Pub. Ch. No. 978 of 2016)	Both tax & fees	6%	Adjusted revenues of a fantasy sports contest offered by a fantasy sports operator to Tennessee consumers	To be established by SOS: 1. Nonrefundable application fee; 2. Nonrefundable fee for licensure; 3. Annual licensure renewal fee; 4. Late fees; 5. Correction of information fee; 6. Change of information fee; 7. Online transaction fee.	No projections conducted by Tenn. legislature	Secretary of State, Division of Charitable Solicitations, Fantasy Sports and Gaming
Vermont (Act 70 of 2017)	Fee			\$5,000 annual registration fee	Projected: \$80,000	Secretary of State; Office of the Attorney General
Virginia (S.646 of 2016)	Fee			1. \$50,000 initial registration fee 2. Subsequent fee to be set by regulating agency (none apparently charged)	As of 10/12/17: 9 companies are registered in VA (total actual revenue = at least \$400,000).	Department of Agriculture and Consumer Services