

Taxation Of The Gambler

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Gambling is BIG Business

- **\$35.64 Billion** – Commercial and Racetrack Casinos
- **\$26.6 Billion** – Indian Casinos
- **\$53.0 Billion** – 2006 Lottery Ticket Sales
- **\$115.24 Billion** – Total gross gaming receipts

Gambling is BIG Business

2012 State of the States - The AGA Survey of Casino Entertainment (does not include tribal gaming information)

- **\$35.64 Billion** – Gross Gaming Revenue (down from \$37.52 Billion in 2007)
- **\$12.9 Billion** – Wages Paid
- **\$7.93 Billion** – Direct Gaming Taxes Paid
- **339,098** – People Employed

Gambling is BIG Business

2012 State of the States - The AGA Survey of Casino Entertainment (does not include tribal gaming information)

- **\$115.24 Billion** – Total gross gaming receipts
- **\$97.6 Billion** – Cable Television
- **\$10.9 Billion** – Outdoor Equipment
- **\$10.6 Billion** – U.S. Movie Box Office Receipts
- **\$7.0 Billion** – U.S. Music Revenue

Gambling is BIG Business in Oklahoma

- 837,114 Total Gaming Machines in USA (slot machines, video poker, etc.)
- #1 Nevada – 183,319 Gaming Machines (21.9%)
- #2 California – 67,601 Gaming Machines (8.1%)
- **#3 Oklahoma – 65,400 Gaming Machines (7.8%)**
- #4 Louisiana – 41,418 Gaming Machines (4.9%)
- #5 Mississippi – 36,150 Gaming Machines (4.3%)

Gambling is BIG Business in Oklahoma

- 459 Total Tribal Casinos in USA
- **#1 Oklahoma – 114 Tribal Casinos (24.8%)**
- #2 California – 70 Tribal Casinos (15.3%)
- #3 Minnesota – 38 Tribal Casinos (8.3%)
- #4 Washington – 34 Tribal Casinos (7.4%)
- #5 Wisconsin – 29 Tribal Casinos (6.3%)

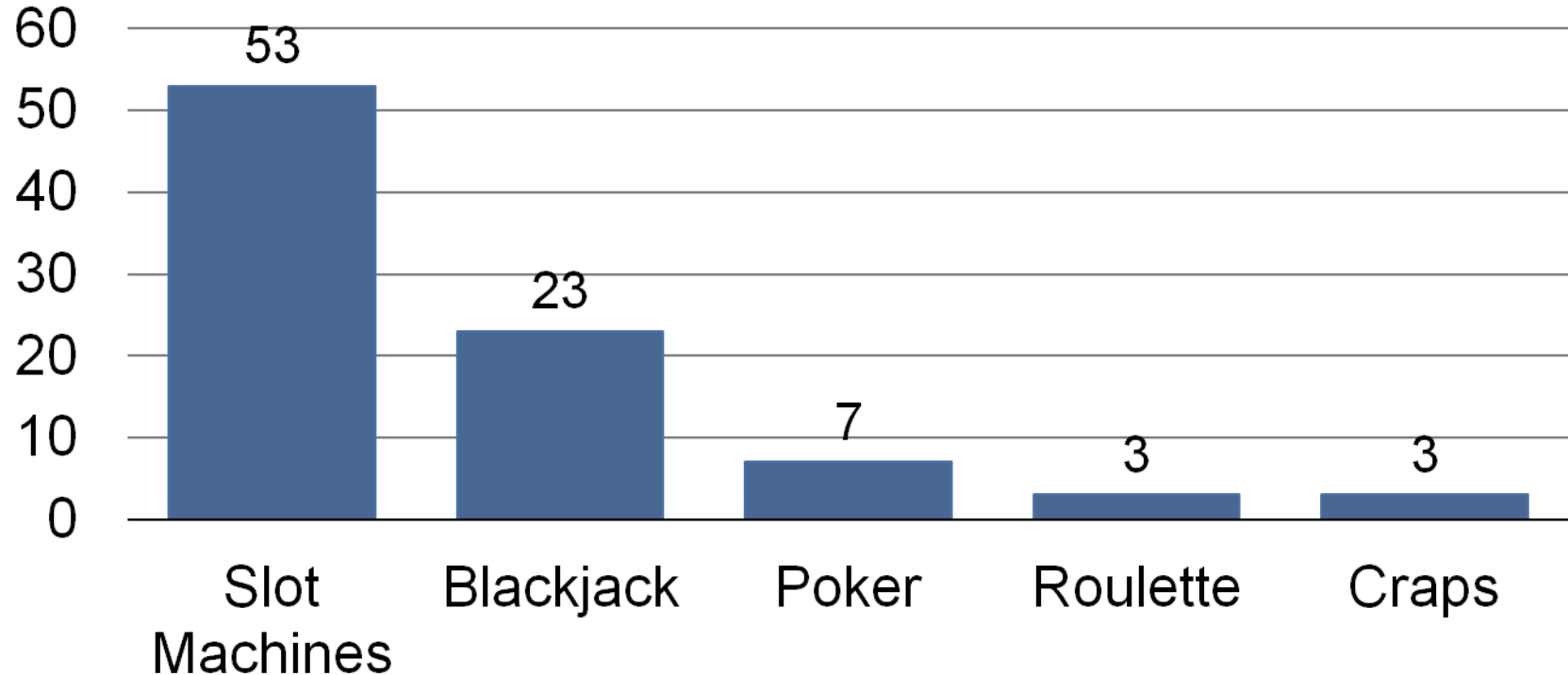
Gambling is BIG Business in Oklahoma

- **National Indian Gaming Commission** - Mission to regulate gaming activities on Indian lands for the purpose of shielding Indian tribes from organized crime and other corrupting influences
- **7 Regional Offices**
- Portland OR, Sacramento CA, Phoenix AZ, St. Paul MN, Washington DC
- **Tulsa, OK** - Eastern OK and Kansas
- **Oklahoma City, OK** - Western OK and Texas

Gambling is BIG Business in Oklahoma

- **National Total** - \$26.5 Billion generated by 422 operations
- **Tulsa, OK** (Eastern OK and Kansas) - \$1.77 Billion (6.7%) generated by 65 operations (15.1%)
- **Oklahoma City, OK** (Western OK and Texas) - \$1.58 Billion (6.0%) generated by 51 operations (11.6%)
- **Total for Tulsa and OKC offices** - \$3.35 Billion (12.6%) generated by 116* operations (26.7%)
(*NOTE: 114 tribal casinos and 2 racinos)

Top 5 Favorite Casino Games by %



IRC Section 61 and Rev. Rul. 54-339

- IRC Section 61. Except as otherwise provided in this subtitle, ***gross income means all income from whatever source derived*** except as otherwise provided by law [emphasis added]
- Rev Rul. 54-339. [I]t is held that for Federal income tax purposes, ***all*** wagering gains must be included in gross income. [emphasis added]
- Bauman v. Commissioner. Disabled Social Security recipient played 4 nickels and hit a \$73,733 jackpot. Testified that he had always heard that SS recipients didn't have to pay any income tax on gambling income.

IRC Section 165(d) Wagering Losses

Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

Previously, Section 23(g) of IRC of 1934. Language is identical. May need to know this for legal research.

Deductions from gross income are a matter of legislative grace, to be bestowed or withheld by Congress.

If \$10,000 of wagering gains and \$8,000 wagering losses, then losses not limited. If \$8,000 of wagering gains and \$10,000 of wagering losses, then wagering losses are limited to \$8,000.

How to Report Wagering Transactions?

- Report “wagering gains” on Form 1040, Page 1, Line 21 “Other Income” as “Gambling Winnings” (see IRS Form 1040 Instructions)
- If elects standard deduction, then no deduction for Gambling Losses allowed. Please see IRS Rev. Rul. 54-339, IRS Chief Counsel Advice Memorandum 2008-011 and Shollenberger v. Commissioner.
- If elects to itemize his deductions on Schedule A, then Gambling Losses treated as Other Miscellaneous Deductions not subject to 2% limitation and described as “Gambling Losses to the Extent of Gambling Winnings”
- This bifurcation results in the “Gambler's AGI Penalty”

How to Report Wagering Transactions?

- **Example #1** – \$1,000,000 from McDonald's Monopoly game token
- **Example #2** – \$1,000,000 winning lottery ticket
- **Example #3** – \$20 Losing lottery ticket
- **Example #4** – \$1,000,000 winning lottery ticket and \$20 losing ticket. Transaction v. Activity
- **Example #5** – \$1,000,000 winning lottery ticket. All proceeds lost buying losing lottery tickets. AGI Penalty

Gambler's AGI Penalty

- Adjusted Gross Income (AGI) - bottom number on Form 1040, Page 1
- AGI used as a cap to phase out certain deductions and credits (i.e. IRA contributions, etc.)
- AGI used as a multiplier to determine amount of certain deductions (i.e. medical expenses, etc.)

Gambler's AGI Penalty Income

- Social Security - more of payments received considered taxable
- IRA contributions phased-out until disallowed entirely

Gambler's AGI Penalty Schedule A Deductions

- Medical expense deductions (7.5% of AGI in 2010, and 10% after December 31, 2012)
- Medicare insurance premiums
- Real estate taxes
- DMV taxes (based on value of car)
- Mortgage interest
- Points on home loan

Gambler's AGI Penalty Schedule A Deductions

- Charitable contributions
- Casualty loss deductions (think tornado, ice storm, hail storm, etc.)
- Employee business expenses
- Miscellaneous itemized deductions subject to the 2% limit (this is 2% of AGI!)

Gambler's AGI Penalty Credits

- Child tax credit
- Earned income credit
- Lifetime learning credit
- Hope credit
- Retirement savings contribution credit
- Adoption credit

Gambler's AGI Penalty

Other

- Rental real-estate deductions
- Investment interest
- Alternative Minimum Tax (AMT)

Gambler's AGI Penalty

“Lazy” Solutions

- Taxpayers rely upon casino win/loss statements that summarize total activity – **NOT** individual transactions!
- Casino win/loss statements also include disclaimers stating they are not reliable for accounting or tax purposes.
- Such a “lazy” solution frequently triggers an audit
- The IRS will fight hard to force the “un-netting”! Shollenberger v. Commissioner was fought over \$555!
- Taxpayers argue they are Professional Gamblers
- Example #6 – Taxpayer handicapped dog races

Gambler's AGI Penalty

Professional Gamblers

- Allowed to "net" losses against winnings on IRS Schedule C - No AGI Penalty
- Can deduct other "ordinary and necessary" business expenses. See Mayo and IRS CCAM 2008-013
- May be liable for self-employment taxes
- If strategy backfires, Taxpayer may be liable for various penalties such as accuracy-related penalty of 20%. See Merkin v. Commissioner

Gambler's AGI Penalty

Professional Gamblers

- This is a regular tax-law issue – facts applied to typical factors
- Needs to smell like a "trade or business" - factors which have impressed courts include:
- Systematic record keeping regardless of how informal or primitive
- Profit motive - doesn't require that money actually made
- Time spent – Courts have recognized that taxpayers can be involved in more than one trade or business, but gambling activity must have regularity and significant time involved
- **WARNING:** New twist at State level. Game of Skill (e.g. poker, black jack) v. Game of Chance (e.g. slot machines, lottery)

Gambler's AGI Penalty

Professional Gamblers

- 4 helpful cases - interesting continuum since Groetzing
- Barrish v. Commissioner, TC Memo 1984-602 (US Tax Court, 1984). Harvard Law School graduate developed a system for dog racing. Yes.
- Commissioner v. Groetzing, 480 U.S. 23 (1987). Parimutuel dog racing. Yes.
- Castagnetta v. Commissioner, TC Summary Opinion 2006-24 (US Tax Court, 2006). Truck driver handicapped horses. Yes.
- Merkin v. Commissioner, TC Memo 2008-146 (US Tax Court, 2008). Park Avenue psychiatrist played video poker. No.

Gambler's AGI Penalty

Professional Gamblers

- Initially, status of Professional Gambler was not allowed since the taxpayer was making bets on his own account. Gentile v. Commissioner defined "carrying on a trade or business" as holding oneself out to others as engaged in the selling of goods or services. Only casinos and "bookies" could meet this definition. See also Estate of Cull v. Commissioner.
- Then, US Supreme Court decided Commissioner v. Groetzinger, 480 U.S. 23 (1987). Taxpayer spent 60 to 80 hour/week betting on dog races

Gambler's AGI Penalty Phantom Income

- Example # 7 – More common situation
- \$100,000 played on slot machines with 95% pay-out until 10 cents left
- \$100,000.00 ---> \$95,000.00 ---> \$90,250.00 ---> \$85,737.50 ---> \$81,450.63, etc.
- After 269 laps, have “cash-ins” of \$2,000,000.26 and gambling winnings of \$1,900,000.36
- If “add-down”, AGI is increased by \$1,900,000 !!!
- W-2G's confirm amount of winnings. On audit, IRS requires proof of losses. If taxpayer can't prove the losses, then taxable income increased by \$1.9 million !!!
- Phantom Income: Handle v. Gross Gambling Revenue

Gambling Session

- Courts, IRS and Tax Professionals have developed concept of "Gambling Session"
- Report the total of all WINNING "Gambling Sessions" on Form 1040, Page1, Line 21 "Other Income"
- Report the total of all LOSING "Gambling Sessions" on Schedule A, Other Miscellaneous Deductions as "Gambling Losses to the Extent of Gambling Winnings"

Gambling Session

- Reece's definition (not from IRS documents or specific Court case): a discrete, isolated time period where the Gambler/Taxpayer is performing a specific action or activity
- **Example #1** - if only played slot machines at a single casino over 3 days, then have a minimum of 3 Gambling Sessions
- **Example #2** - if only played slot machines at two casinos during 1 day, then have a minimum of 2 Gambling Sessions

Gambling Session

- **Example #3** - if played slot machines AND poker at a single casino, then have a minimum of 2 Gambling Sessions
- **Example #4** - if played at a \$100 blackjack table and then later moved to a \$500 blackjack table, then have a minimum of 2 Gambling Sessions
- **Example #5** - if played in a 3-day poker tournament, then have 1 Gambling Session

Gambling Session

- **Example #6** - if place bets at the race track, then each individual race is considered a Gambling Session
- **IMPORTANT:** Taxpayers are to group transactions together based on **TIME AND PLACE** component!
- **REMEMBER:** The more detailed and specific you can describe each Gambling Session, then the more likely you are to prevail against the IRS
- ***PROVE IT OR LOSE IT !!!***

The J+O-I of Gambling Income

- **J** = Hand Paid Jackpots **PLUS**
- **O** = Coin-Out or Cash-Out **MINUS**
- **I** = Coin-In or Cash-In **EQUALS**

GAMBLING INCOME

The J+O-I of Gambling Income

- **J** = Hand Paid Jackpots - IRS requires casinos to issue W-2G's when a Gambler/Taxpayer wins \$1,200 or more. **PLUS**
- **O** = Cash-Out - amount returned to Gambler/Taxpayer when press "Cash Out" button, or amount received when redeem chips. Two possible sources: 1.) amount not wagered yet (In "accountant-speak", this is the return of your basis); or 2.) net accumulated jackpots of less than \$1,200. **MINUS**

The J+O-I of Gambling Income

- **I** = Cash-In - the amount of coin or currency inserted into the slot machine. Amount of chips bought. In "accountant-speak", this is your basis. **EQUALS**
- **GAMBLING INCOME**
- Examples based on IRS Chief Counsel Advice Memorandum 2008-011, Reporting of Wagering Gains and Losses.

How To Prove Wins & Losses?

IRS Revenue Procedure 77-29

- IRS recommends Gambler/Taxpayer keep a gambling diary or log
- IRS specifies the information to report.
- Date and type of specific wager or wagering activity
- Name of gambling establishment
- Address or location of gambling establishment
- Names of other persons present with Gambler/Taxpayer

How To Prove Wins & Losses?

IRS Revenue Procedure 77-29

- **CARVR** standard for documentation
- **Contemporaneous**
- **Adequate**
- **Regular**
- **Verifiable**
- **Records**

How To Prove Wins & Losses?

IRS Revenue Procedure 77-29

- Amount won or lost
- Available documentation - W-2G's, 1099-MISC's, hotel bills, airline tickets, bank statements, credit card statements, canceled checks, etc.
- Information specific to type of wager, i.e. keno, slot machines, table games, bingo, racing, lotteries (see IRS Revenue Procedure 77-29 for specifics)

How To Prove Wins & Losses? If No Gambling Diary!

- Use what you have got - Courts have been lenient with taxpayers that produced contemporaneous records (e.g. scraps of paper, napkins, etc). But remember, Tax Court is Court of Law ***NOT a Court of Equity!***
- Recreate it as best you can
- Remember Courts have refused to recognize bank statements, ATM receipts, casino win/loss statements (amounts are "netted") and Player's cards

How To Prove Wins & Losses? If No Gambling Diary!

- The Cohan Rule (Broadway's George M. Cohan)
- Judge Learned Hand of the 2nd Circuit in 1930
- Taxpayer can use reasonable estimates but round down so as to favor the IRS. REMEMBER: it is the Taxpayer's fault (and burden) that complete records are not available
- See Doffin v. Commissioner, TC Memo. 1991-114 (US Tax Court, 1991) for favorable application to Gambler
- Courts have frequently rejected Cohan - especially when no documentation at all provided by Taxpayer.

Issue Spotting

Net Operating Losses (NOL's)

- No "carry-overs" of NOL's to different years. Period
- Gambling losses from one type of activity (i.e. slot machines) can be offset against winnings from another type of activity (i.e. lottery, comps)
- Husband and Wife may offset their winnings and losses if filing status is Married Filing Joint
- Gambling losses can ONLY offset gambling winnings
- "Comps" can be used to offset losses (LiButti v. Commissioner, TC Memo 1996-108)

Issue Spotting

Net Operating Losses (NOL's)

- Zarin v. Commissioner, 916 F.2d 110 (3rd Cir. 1990), reversing 92 Tax Court 1084 (1989).
- In 1979 and 1980, Taxpayer lost \$3.4 million dollars playing craps
- Taxpayer gave "markers" to casino; Casino sued when Taxpayer did not repay debt
- In 1981, settled debt with casino for \$500,000
- On audit, IRS said Taxpayer had \$2.9 million in ordinary income (forgiveness of debt); Tax Court agreed;
- 3rd Circuit overruled Tax Court
- 10th Circuit criticized in Preslar v. Commissioner, 167 F.3d 1323, 1328 (10th Cir. 1999)

Issue Spotting

Form 5754 Statement by Person(s) Receiving Gambling Winnings

- Used for Workplace Lottery Pools (e.g. group of American Airline mechanics based in Tulsa)
- Used for "sponsored" tournament teams - For example, a poker tournament may have a \$10,000 entry fee. So contestant may find people to help pay fee with promise to share winnings.
- BE CAREFUL! Many of these agreements are informal and verbal. May offend casino or tournament officials. May not be recognized or requested by casino.
- Submitted to casino so separate W-2G's issued to other people.
- Purpose to share "Gambler's AGI Penalty" among everyone receiving winnings

Issue Spotting

Beware the SAR's

Suspicious Activity Reports

- Casinos, financial institutions, etc. required to report cash transactions of \$10,000 or more within a 24-hour period (holdover from the 1980's days of money laundering – now we blame the terrorists)
- If try to avoid \$10,000 limit, then casino employee required to report Taxpayer's efforts
- If act "suspicious", regardless of amount, then casino employee required to report Taxpayer
- Casino **explicitly** instructed to **NOT** notify Gambler/Taxpayer
- At very least, Taxpayer will probably be audited

Summary

- Gambling is BIG Business in Oklahoma
- Section 165 (d) – only 17 words
- Report “Wins” on Form 1040, Page 1, Line 21
- Report “Losses” on Schedule A, if itemize
- Gambling Session
- Gambler’s AGI Penalty
- Use a Gambling Diary (or recreate as best as possible)
- The J+O-I of Gambling Income
- Net Operating Losses (NOL’s)
- Professional Gamblers use Schedule C
- Form 5754 – 2+ Winners
- Beware the SAR’s

Summary

Good Luck!